DOWNGRADE

MALAYSIA

RUBBER GLOVES

SHORT TERM (3 MTH)	LONG TERM
TRADING BUY	OVERWEIGHT
TRADING SELL	**NEUTRAL**
	UNDERWEIGHT

Notes from the Field

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"Players are expanding their capacity and we expect intense competition, as there will be more capacity in the market for nitrile gloves. Profit margins for nitrile will continue down to 9-11%.

– Datuk Seri Stanley Thai,
Supermax Corporation Bhd

Highlighted Companies

Kossan
Valuations of the stock are attractive at only 9.7x CY14 P/E, a 28% discount to the sector and a 38% discount to our target market P/E. We believe this is unjustified as demand for nitrile gloves is robust, raw materials prices are stable and the company's 1Q13 results were the strongest among its peers. Kossan is now our top pick and we expect the share price to re-rate on the back of the catalysts above.

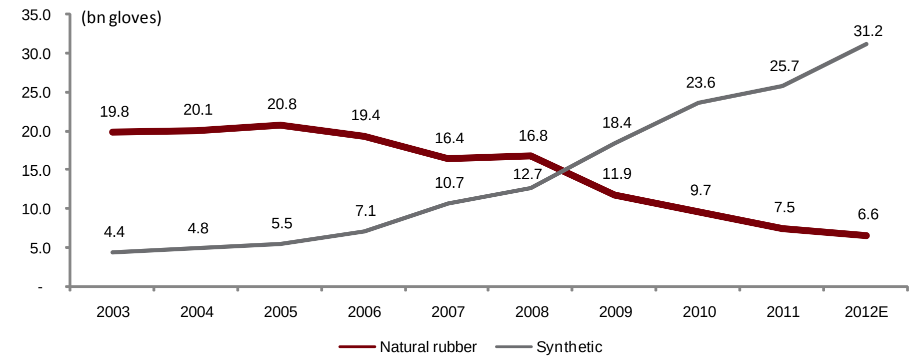
Hartalega
The world's largest glovemaker will start construction of its 24bn-piece-per-annum glove complex (NGC) in Sep 2013, its most ambitious plan yet to cement its position as the sector's bellwether glovemaker. Since we started covering the stock in Sep 2010, Hartalega has been our top pick - returning 170% compared to the KLCI's 21%. During this period, quarterly earnings grew by 1.5x. However, we expect EPS growth to be mediocre over the next two years as management shifts its attention to building the NGC.

Top Glove
Despite being the world's biggest glovemaker by capacity, Top Glove has the most volatile earnings in the sector due to its low margins and high operating leverage. The company has recently been weighed down by its large size, which we believe has prevented it from switching its product mix quickly and responding to changing consumer demand. To arrest its fall, management aims to become the largest nitrile glovemaker in the world over the next few years.

Closing time

After returning 170% since 2010, Hartalega's superb run has come to a close as risks of overcapacity and competition build up. We downgrade the stock to Neutral and reduce the sector from overweight to Neutral. While nitrile demand is robust, the market is ignoring competitive and pricing risks as glovemakers build capacity too aggressively.

Figure 1: US imports of natural rubber and nitrile gloves



SOURCES: CIMB, COMPANY REPORTS

In such a transformative stage of the sector's cycle, we think picking winners requires a more selective approach. Our new top pick is Kossan which remains an Outperform for its undemanding valuations and strong earnings momentum. We re-calibrate our target prices but make no other changes to our ratings.

What a run

Nitrile demand is strong, rising by 20% annually with utilisation rates full at 85-90% and lead times up to 90 days. By comparison, natural rubber gloves have been abandoned, with demand growing less than 5%. Top Glove reported in its 3Q13 that demand is weak with lead times of only 30 days, making it difficult for the company to pass costs through when raw material cost rises. Of the gloves imported to the US in 2012, 82.5% are synthetic and only 17.5% are natural rubber. This is a mirror image of the stats nine years ago in 2003. Hartalega has been the primary beneficiary of this trend. Since its IPO in 2008, quarterly net profit has risen by 4.8x and its share price is 12x higher. It is now the world's most valuable glovemaker and its market exceeds Top Glove's by RM600m.

Risks rising

While it is nice to reflect on the run that Hartalega has had, we believe risks of overcapacity and competition are mounting as glovemakers rush to secure customers as demand shifts permanently from natural rubber to nitrile. Already, industry sources say some glovemakers are selling synthetic gloves at a loss to fill new capacity. This may not be sustainable over long periods but it could still inflict short-term pain on the sector.

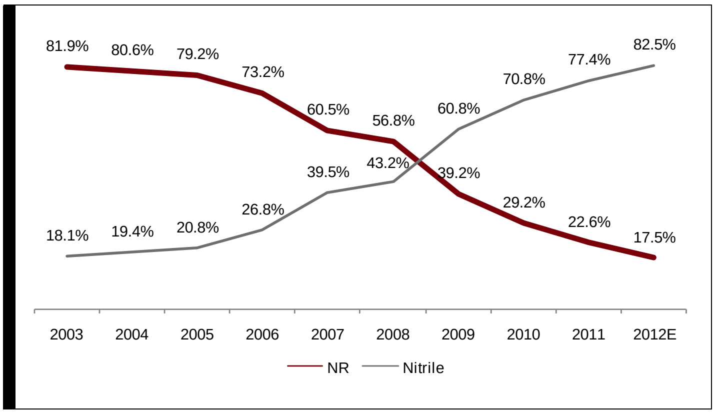
Be selective

In this environment, picking winners will be harder. We believe Kossan stands to gain the most as valuations are cheap and earnings momentum strong. The stock is now our top pick.

KEY CHARTS

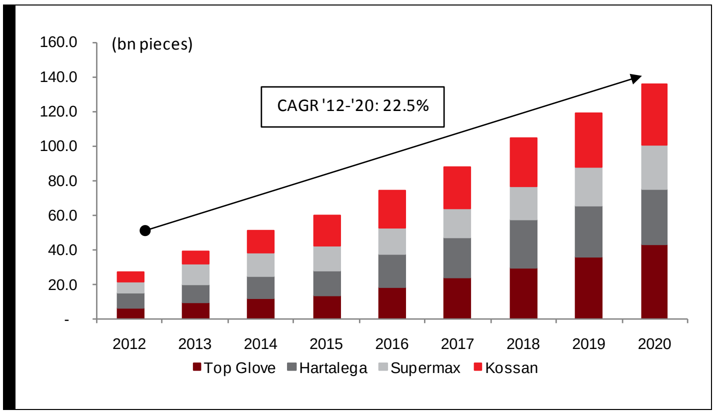
Nitrile gloves are in vogue

Demand for synthetic gloves is strong; glovemakers are reporting that utilisation rates are 'full' at 85-90% with lead times of up to 90 days, meaning capacity is booked ahead for three months. Demand has always been the strongest in the US where consumers are more sensitive to the protein allergies that natural rubber gloves can cause. As the chart on the right shows, the proportion of nitrile gloves imported by the US has risen from only 18.1% in 2003 (or 4.4bn pieces) to 82.5% in 2012 (or 31.2bn pieces). This suggests that synthetic glove consumption has risen by 24.3% annually over the past nine years (refer right) in the US.



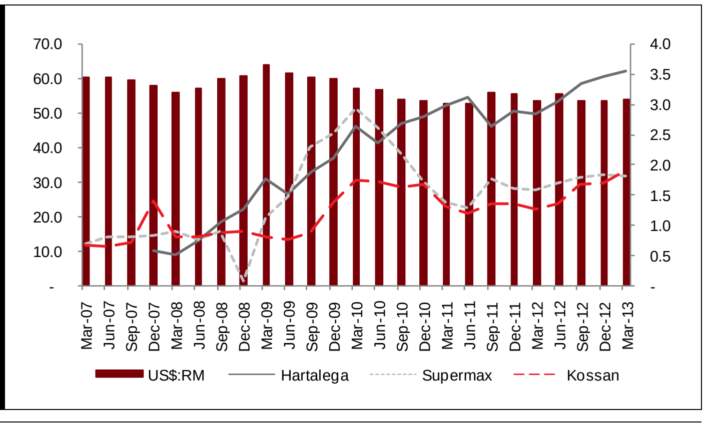
Oversupply, price war brewing

Manufacturing capacity in Malaysia has lagged behind demand due to a shortage of natural gas as Petronas has been reluctant to sell gas at RM16/mmbtu when Japanese exports fetch RM50/mmbtu. Constraints on gas supply should be alleviated later this year as Petronas Gas's 3.8m mt (or 530mmscfd) regasification plant in Malacca has been completed. As such, both Hartalega and Supermax will start building their mega glovemaking complexes later this year, with first gloves rolling off production lines from 2014 onwards (refer right). When this happens, overcapacity and price competition may start to intensify.



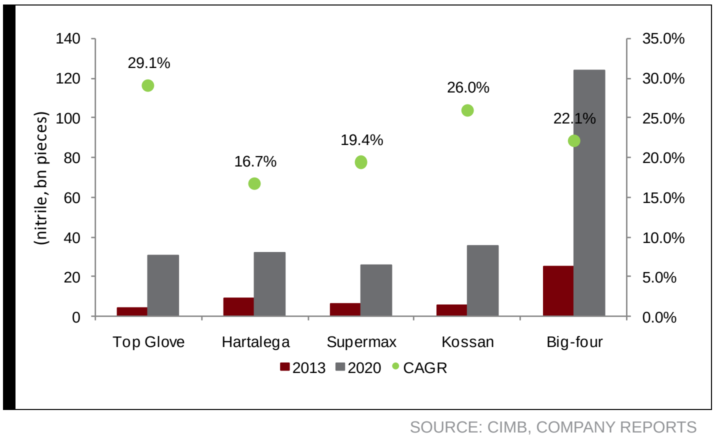
No correlation between EPS and forex

While forex changes, such as the strengthening of the US$-RM cross rate, can have a short-term impact and shift investor sentiment, our analysis shows little correlation between forex movements and earnings growth (refer right). We believe this is because glovemakers hedge their forex exposure regularly and frequently, every few weeks, regardless of the rate and do not normally take speculative bets on the forex level. As a result, gains and losses are minimised and a large movement in one quarter is usually reversed in a future period.



Market is ignoring the risks

We are downgrading Hartalega from outperform to Neutral and the glove sector from overweight to Neutral. We believe the market is pricing in a blue-sky scenario of benign competition and capacity expansion, ignoring the risks of margin erosion, price competition and cost inflation. Also, our analysis suggests that glovemakers are not coordinating their expansion plans as each of the big four appears to be sprinting to become the world's largest glovemaker. Our analysis in this note will show that synthetic capacity could rise by 22.1% annually up to 2020 (refer right), outpacing the sector's historical average demand growth of 8-10%.



SOURCE: CIMB, COMPANY REPORTS

Figure 2: Sector Comparisons

Company	Bloomberg Ticker	Recom.	Price (local curr)	Target Price (local curr)	Market Cap (US$ m)	Core P/E (x)		3-year EPS	P/BV (x)		Recurring ROE (%)			EV/EBITDA (x)		Dividend Yield (%)	
						CY2013	CY2014	CAGR (%)	CY2013	CY2014	CY2013	CY2014	CY2015	CY2013	CY2014	CY2013	CY2014
Hartalega Holdings	HART MK	Neutral	6.15	6.39	1,402	17.9	16.4	10.4%	4.54	3.48	29.5%	24.2%	23.0%	11.5	10.3	2.5%	2.8%
Kossan Rubber Industries	KRI MK	Outperform	4.70	6.44	465	11.7	9.7	14.9%	2.12	1.80	20.0%	20.2%	18.2%	5.8	4.5	1.7%	2.1%
Supermax Corp	SUCB MK	Outperform	1.94	2.26	409	8.7	7.4	8.1%	1.16	1.02	14.5%	14.7%	12.9%	5.3	3.9	2.6%	3.0%
Top Glove Corporation	TOPG MK	Neutral	6.29	6.55	1,211	18.4	16.5	9.5%	2.63	2.39	15.1%	15.2%	na	9.9	8.6	3.6%	4.0%
Average						**15.2**	**13.4**	**6.8%**	**2.63**	**2.25**	**19.0%**	**18.2%**	**18.0%**	**8.8**	**7.4**	**2.8%**	**3.2%**

SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Calculations are performed using EFA™ Monthly Interpolated Annualisation and Aggregation algorithms to December year ends

Closing time

Table of Contents

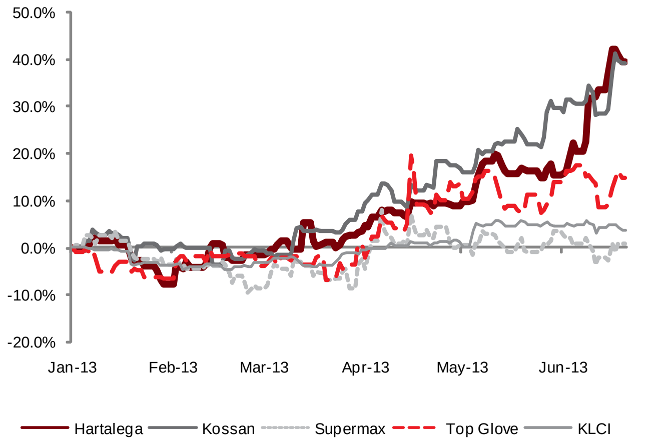
1. BACKGROUND

1.1 YTD price performance

YTD, the four glove stocks under our coverage have recorded an absolute return of 1-39% (Figure 3,4), outperforming the KLCI YTD by up to 36% (Hartalega), while the sector has outperformed the KLCI by an average of 22.9% (Figure 6) on a market-cap-weighted basis.

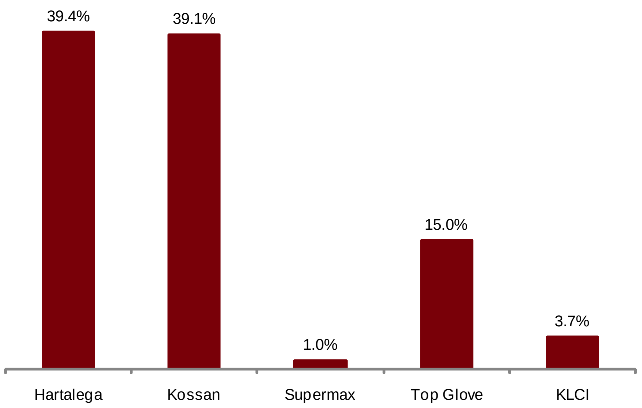
We believe this analysis validates our Overweight rating on the sector and our upgrade call at the beginning of 2013. The sector's performance was likely catalysed by the bird flu outbreak in China, stable raw material prices, confirmation of new gas supply from LNG and strong demand for nitrile gloves.

Figure 3: Absolute return YTD June 2013 (%)



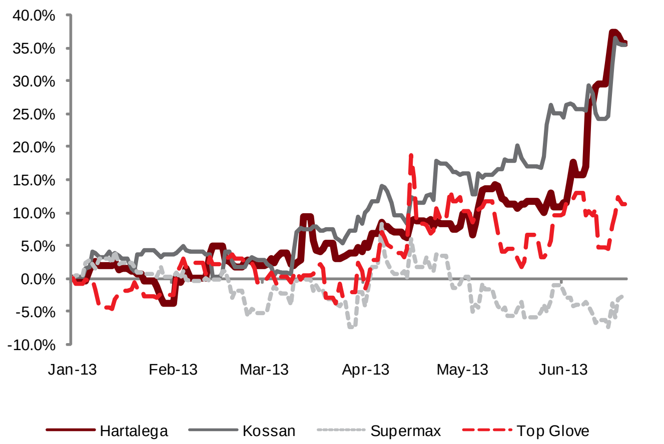
SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 4: Absolute return YTD June 2013 (%)



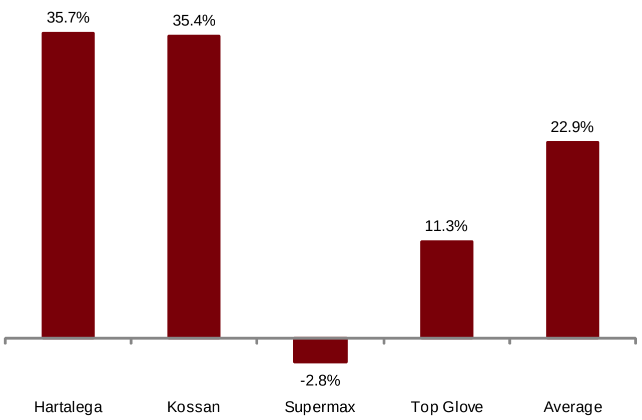
SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 5: Relative return YTD June 2013 (%)



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 6: Relative return YTD June 2013 (%)



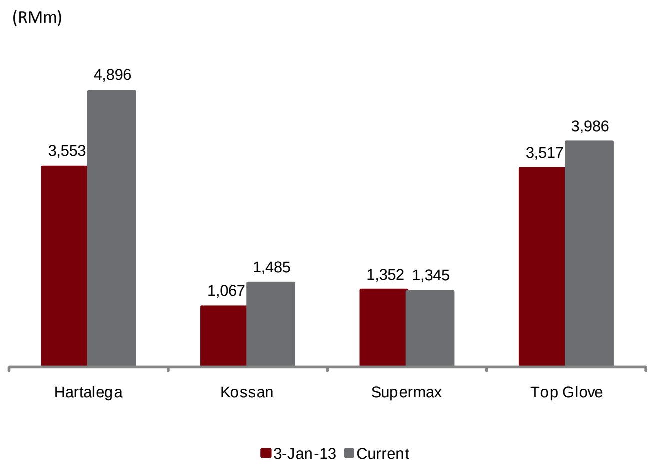
SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

So far in 2013, Hartalega has continued to establish itself as the benchmark glovemaker in the sector as it tops its peers in innovation, profitability and valuation.

For example, Figure 7 shows that at the beginning of 2013, Top Glove and Hartalega were of equal market-cap sizes but now Hartalega's market cap is 16% or c.RM600m greater than Top Glove's.

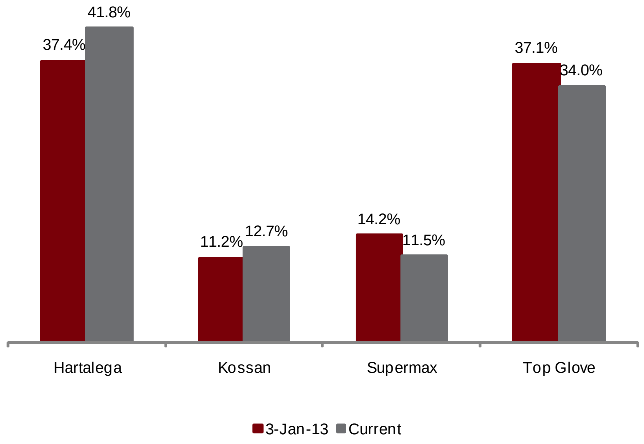
As a result, Hartalega's share of market capitalisation among the top four glovemakers has risen from 37.4% to 41.8% (Figure 8). Note that Kossan's share has also increased, while Supermax and Top Glove's share has declined.

Figure 7: Market capitalisation comparison



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 8: Share of market capitalisation

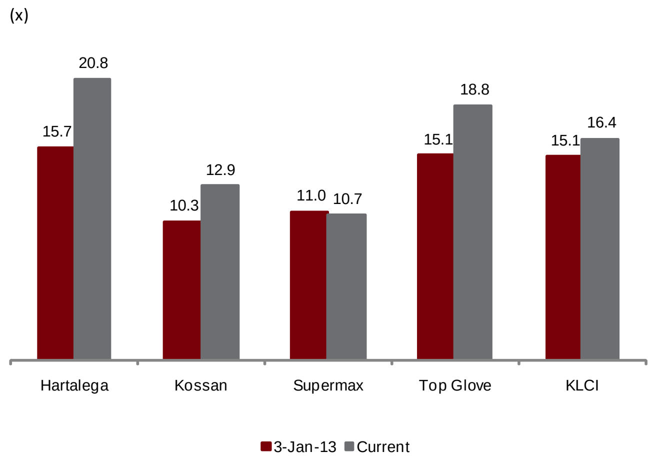


SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

1.2 Valuation and earnings momentum

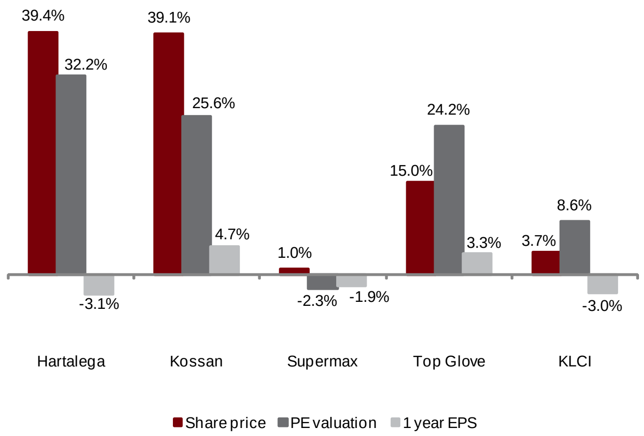
Bloomberg data suggest that the price movements of the glove stocks have been mainly due to changes in the P/E multiple, not earnings. Figure 10 shows that Hartalega's YTD share price appreciation of 39.4% comes mainly from the expansion of its P/E multiple from 15.7x to 20.8x (+32.2%) as EPS has fallen by 3.1% over the same period.

Figure 9: P/E multiple evolution



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 10: Share price against P/E and EPS evolution

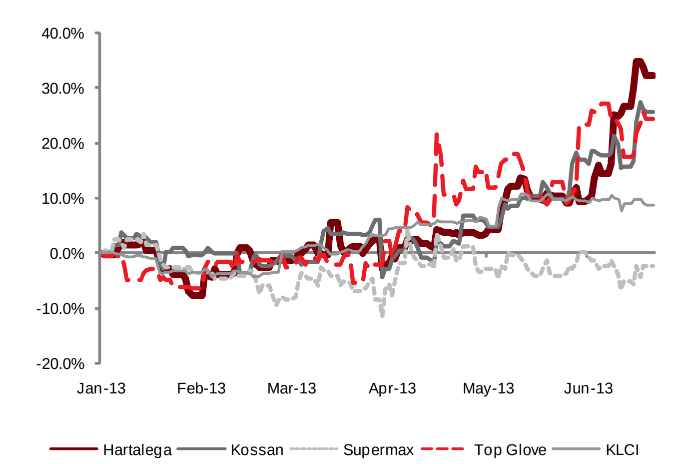


SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Kossan's and Top Glove's share price appreciation meanwhile appears more balanced as both the P/E multiple and EPS have risen together with the share price.

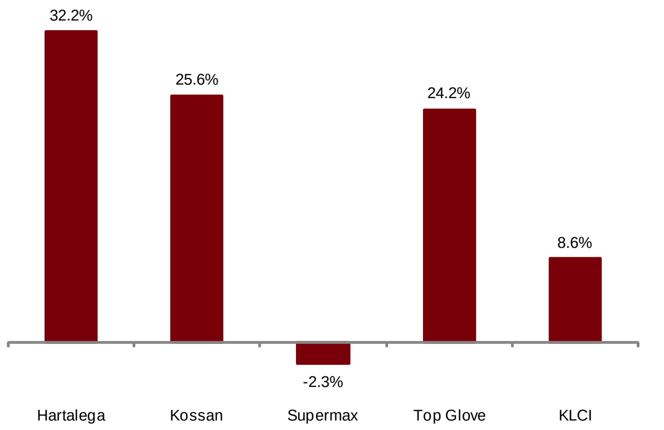
Supermax has had the worst of both worlds as both the P/E multiple and consensus EPS have fallen since the beginning of the year. The lower P/E multiple could be due to "controversial comments" by Supermax's CEO and falling associate income from its Brazilian distributors.

Figure 11: P/E evolution for the glove sector



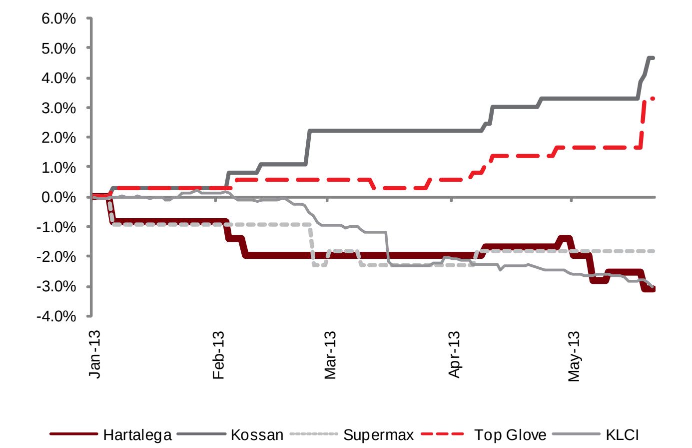
SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 12: P/E evolution for the glove sector YTD June



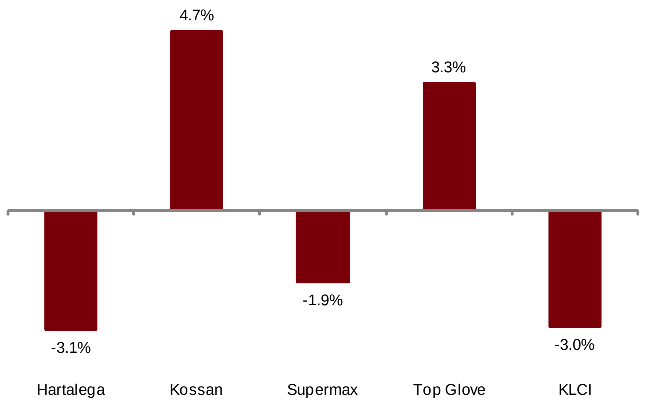
SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 13: Glove sector's 1-year forward EPS evolution



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 14: Glove sector's 1-year forward EPS evolution YTD June



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

1.3 EPF shifts bets

It appears as though Malaysia's Employees Provident Fund (EPF) has switched its glove holdings from Supermax to Hartalega. In May, days after the general elections, EPF raised its stake in Hartalega by 1.8m shares or 0.2%, crossing the 5% mark. This was soon after it reduced its interest in Supermax by 3% (21m shares) over Feb-Apr 13 after Supermax's CEO made "controversial comments". We believe this is positive for Hartalega but a temporary setback for Supermax. The presence of EPF lends credibility to the business model and management team of Hartalega, which is a closely-held family-run business.

1.4 Switching top picks

In this note, we downgrade Hartalega from Outperform to Neutral as we believe most of the good news has been priced in and investors are ignoring the risks of overcapacity. Earnings growth for Hartalega over the next two years will likely be mediocre as management shifts its attention to making the NGC a success.

Valuations are also expensive with Hartalega trading at 16.4x CY14 P/E, 22% above our target market P/E and CY14 yields are low at 2.8%. We believe this does not reflect mediocre earnings growth of 10.4% over the next three years.

Instead, we prefer Kossan as stock would be catalysed by its expansion into technical rubber products (TRP), its undemanding valuation and strong earnings growth.

2. OUTLOOK

2.1 Gas supply constraint lifted

Most glovemaking plants use natural gas as heating fuel for the glove oven. Some companies, like Top Glove, use biomass to complement its gas use and also to diversify its energy needs.

However, natural gas is still preferred because it is cheap, piped direct to the glove plant, easy to control, less polluting and more energy-efficient. However, over the past few years, natural gas has been in short supply and glovemakers have had to scale down expansion plans.

We believe this constraint to growth has been partially resolved as Petronas has begun importing LNG through the Malacca regasification plant in Sungai Udang. The facility has a capacity to import 530mmscfd or 3.8m mt/year of natural gas.

Glovemakers have indicated that new gas supply agreements have been signed and there are no more restrictions on gas supply. Hartalega is a good example of this as the company will start building a 24bn-piece-per-annum glove facility in Sepang in Sep 2013. The management of Hartalega indicated that it has all the necessary gas required for the new plant.

2.2 Nitrile demand strong

The demand for nitrile remains strong and capacity utilisation is full for this product segment. Top Glove indicated that its nitrile lines are 85-90% utilised with demand sold ahead for 70-90 days.

By comparison, natural rubber glove capacity is only 70-80% utilised and glove demand is sold ahead for only 30 days. The company also reported during the 3Q13 that the volume of nitrile glove sales rose by 50% yoy compared to a 17% yoy rise for natural rubber powder-free gloves and a 8% yoy rise for natural rubber powdered gloves. Other glovemakers are also bullish about nitrile demand and have reported similar statistics.

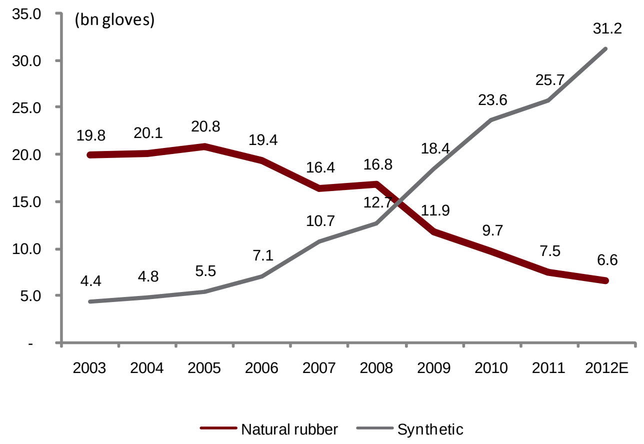
As a result, glovemakers say the demand for nitrile gloves is expected to rise by 20% annually over the next few years while the demand for natural rubber gloves is projected to rise by less than 5% annually.

2.3 Nitrile is now 82.5% of US imports from 18.1% in 2003

At the expense of natural rubber, nitrile demand has soared over the past few years due to a preference for synthetics. This is due to an improvement in glovemaking technology that has enabled manufacturers to make ultra-thin gloves of 3.5 grams versus 5.0 grams for natural rubber variants.

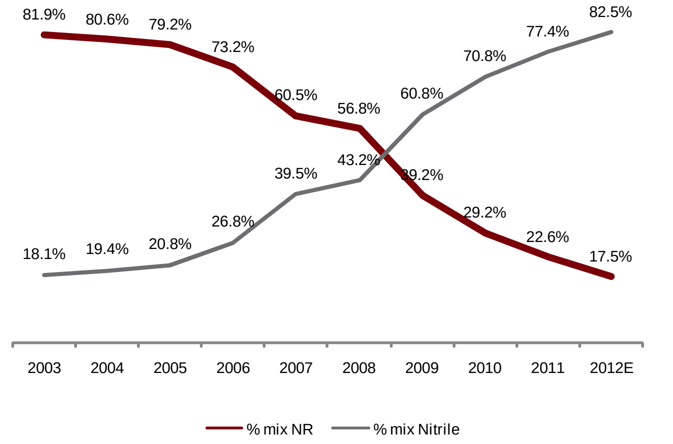
At the same time, an escalation of natural rubber prices during the 2010-2011 commodity boom has inflated the manufacturing cost of natural rubber gloves and made synthetic gloves more affordable.

Figure 15: US glove imports



SOURCES: CIMB, COMPANY REPORTS, HARTALEGA

Figure 16: US glove imports, product mix



SOURCES: CIMB, COMPANY REPORTS, HARTALEGA

This trend has persisted for years and now 82.5% of the gloves imported to the US are synthetic, up from 18.1% nine years ago.

The US has the highest percentage of synthetic glove penetration due to the prevalence of allergic reactions to natural rubber proteins, which appears less of an issue in other countries.

2.4 Overcapacity, price war brewing?

In response to the higher demand for nitrile, glovemakers have ramped up their production of synthetic gloves. Top Glove, for example, intends to increase total capacity by 8.4% annually to 78.2bn pieces annually by 2020.

Over this period, Top Glove aims to become the largest synthetic glovemaker in the world and is designing all new plants to make both natural rubber and synthetic gloves.

Assuming all incremental capacity is nitrile, our analysis suggests nitrile capacity will rise at a greater rate of 29.1% p.a. to 30.8bn pieces annually by 2020 (Figure 17).

Hartalega is making similar plans and will start building the NGC in Sep 2013 with gloves rolling off the new production lines in FY3/15. The full impact of the NGC will be felt the following year in FY3/16. Overall, we expect Hartalega to raise nitrile capacity by 16.7% p.a. and reach 31.7bn pieces annually in 2020, as the company aims to maintain its leadership in the synthetic product segment (Figure 17).

Supermax and Kossan have similar expansion plans as both companies have indicated that they will tilt management resources towards nitrile gloves to respond to the higher demand. As a result, we expect a 19.4% p.a. and 26.0% p.a. increase in synthetic capacity up to 2020 for Supermax and Kossan, respectively.

Overall, we expect the four biggest glovemakers to raise nitrile capacity by 22.1% p.a. over the next eight years, reaching 123.8bn pieces in 2020. While glovemakers indicate that nitrile demand is rising by 20% yearly, capacity expansion is catching up with demand growth and we expect this to exert pressure on selling prices, margins and profitability.

Figure 17: Installed capacity (bn pieces)

Total gloves	2012	2013	2014	2015	2016	2017	2018	2019	2020	CAGR	Comments
Top Glove	41.1	44.6	46.6	48.6	53.4	58.7	64.6	71.1	78.2	8.4%	Company forecast up to 2015, +10% p.a. after
Hartalega	9.7	11.0	14.1	15.4	20.0	24.7	29.4	30.8	33.4	16.7%	Company forecast, includes NGC
Supermax	17.8	23.1	25.0	26.0	27.0	28.0	30.8	33.9	37.3	9.7%	Company forecast up to 2017, +10% p.a. after
Kossan	14.0	16.0	21.0	26.0	30.0	33.0	36.3	39.9	43.9	15.4%	Company forecast up to 2017, +10% p.a. after
	82.6	94.7	106.6	116.0	130.4	144.5	161.1	175.7	192.8	11.2%	

Synthetic gloves	2012	2013	2014	2015	2016	2017	2018	2019	2020	CAGR	Comments
Top Glove	4.0	7.5	11.6	14.8	18.0	21.2	24.4	27.6	30.8	29.1%	Company forecast (+3.2bn from FY15 onwards)
Hartalega	9.2	10.5	13.4	14.7	19.0	23.5	27.9	29.2	31.7	16.7%	Assume 95% of capacity is nitrile
Supermax	6.2	11.5	13.4	14.4	15.4	16.4	19.2	22.3	25.7	19.4%	FY13 onwards, incremental capacity is nitrile
Kossan	5.6	7.6	12.6	17.6	21.6	24.6	27.9	31.5	35.5	26.0%	FY13 onwards, incremental capacity is nitrile
	25.0	37.0	51.0	61.5	74.0	85.7	99.4	110.7	123.8	22.1%	

Natural rubber gloves	2012	2013	2014	2015	2016	2017	2018	2019	2020	CAGR	Comments
Top Glove	37.1	37.1	35.0	33.8	35.4	37.5	40.2	43.5	47.4	3.1%	Implied
Hartalega	0.5	0.6	0.7	0.8	1.0	1.2	1.5	1.5	1.7	16.7%	Implied
Supermax	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	11.6	0.0%	Implied
Kossan	8.4	8.4	8.4	8.4	8.4	8.4	8.4	8.4	8.4	0.0%	Implied
	57.6	57.6	55.6	54.5	56.4	58.8	61.7	65.0	69.0	2.3%	

SOURCES: CIMB, COMPANY REPORTS

The massive increase in nitrile capacity would move the industry from being 30% nitrile gradually upwards to 53% by the time Hartalega's NGC is fully online in 2015.

This would mark a dramatic shift in product mix where natural rubber gloves have long dominated. From 2015 onwards, if glovemakers hold to their expansion plans, nitrile will eventually make up 64% of the mix in 2020.

Figure 18: Product mix (% total capacity)

Synthetic gloves	2012	2013	2014	2015	2016	2017	2018	2019	2020
Top Glove	10%	17%	25%	30%	34%	36%	38%	39%	39%
Hartalega	95%	95%	95%	95%	95%	95%	95%	95%	95%
Supermax	35%	50%	54%	56%	57%	59%	62%	66%	69%
Kossan	40%	48%	60%	68%	72%	75%	77%	79%	81%
	30%	39%	48%	53%	57%	59%	62%	63%	64%

Natural rubber gloves	2012	2013	2014	2015	2016	2017	2018	2019	2020
Top Glove	90%	83%	75%	70%	66%	64%	62%	61%	61%
Hartalega	5%	5%	5%	5%	5%	5%	5%	5%	5%
Supermax	65%	50%	46%	45%	43%	41%	38%	34%	31%
Kossan	60%	53%	40%	32%	28%	25%	23%	21%	19%
	70%	61%	52%	47%	43%	41%	38%	37%	36%

SOURCES: CIMB, COMPANY REPORTS

2.5 Some glovemakers are undercutting its peers

We gather from industry sources that some glovemakers have begun aggressively slashing selling prices for its synthetic gloves. We understand that one leading glovemaker may be selling nitrile gloves for as low as US$24/1k pieces compared to the market price of US$29/1k pieces or a 17% discount to current prices.

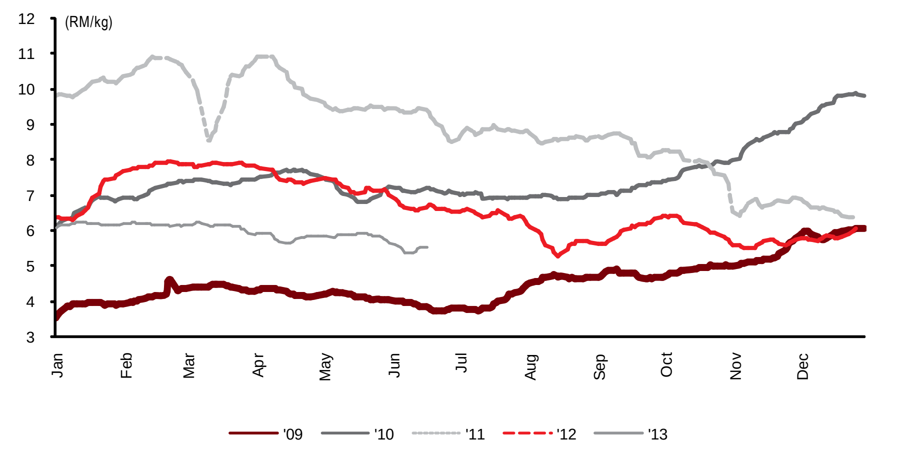
If true, this could have a negative impact on the industry in the short run. However, we do not think this is sustainable at current raw material prices as the cash cost for nitrile gloves is RM27.45/1k pieces, based on our estimates, implying that at such a low price nitrile gloves are being sold at a loss.

2.6 Natural rubber price outlook

Glovemakers in Malaysia expect the natural rubber price to remain at current levels as current prices enable both suppliers and consumers of the commodity to earn stable profits.

Also, there appear to be few demand-driven catalysts for natural rubber prices as economic data out of China (the world's largest consumer) remain uncertain and the US Federal Reserve is posturing a moderation to quantitative easing.

Figure 19: Natural rubber latex prices



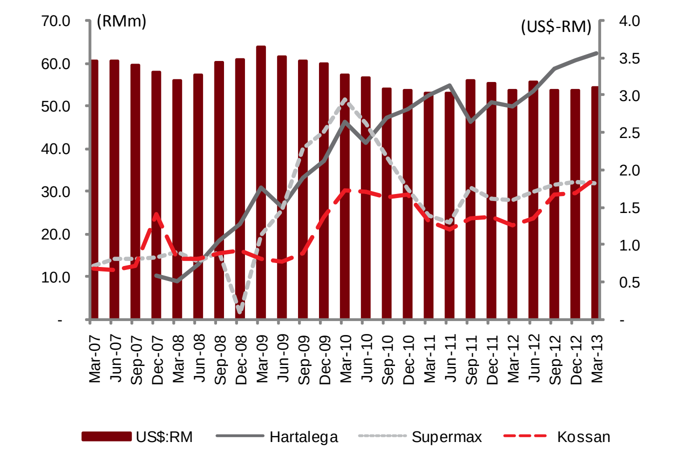
SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

2.7 No long-term correlation between earnings and US$

While there may be a short-term impact from forex volatility, our analysis suggests there is a low correlation between the US$-RM cross rate and earnings. Also, glovemakers do not take speculative views on currency. Instead, they hedge the currency regularly and frequently, which in theory smoothens out any negative or positive impact over time.

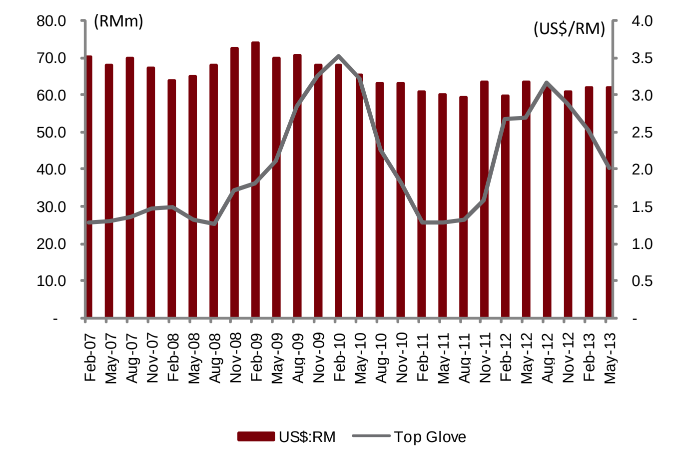
As a result, while a stronger US$-RM rate is positive for sentiment and could drive short-term share prices, over the long run we do not believe small movements in currency will impact earnings.

Figure 20: Net profit vs. forex (by quarter, FYE Mar/Dec)



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 21: Net profit vs. forex (by quarter, FYE Aug)



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

For example, note that for Hartalega, Supermax and Kossan (FYE, Mar/Dec) earnings have continued to increase after the Malaysian ringgit bottomed in mid-2009 at RM3.6 to US$1.0.

Top Glove, by comparison, has seen earnings see-saw over the same period, falling in line with booming natural rubber prices and rising as natural rubber prices moderated.

3. CORPORATE STRATEGIES 2H 2013

3.1 Hartalega

Management will be busy building the NGC in Sepang, where it has taken more than one year to secure the land purchase. Construction is expected to start in Sep 2013.

To put things into perspective, Hartalega held its one and only analyst briefing ever in April 2012 to talk about the NGC but only announced this month that the land purchase is complete and construction can go ahead.

3.2 Top Glove

The world's largest glovemaker will continue to expand its nitrile capacity and transition from being a natural rubber glovemaker to one that is more balanced. Three glovemaking plants that can produce a total of 3.6bn pieces per annum are expected to be completed by the end of the year, in June (0.8bn), Aug (2.0bn) and Dec (0.8bn).

With natural glove demand low, utilisation for natural rubber glove lines is only 70-80% and the company is quickly attempting to recalibrate its product mix from 17% nitrile currently to 50% nitrile over the next few years.

Management has also stated that its goal is to become the world's largest nitrile player, signalling its belief that the switch to nitrile could be permanent.

3.3 Kossan

In addition to adding new capacity and ramping up nitrile production, Kossan is focusing on diversifying its product base to include technical rubber products (e.g. conveyer belts) in Indonesia.

This is a good move, in our view, as the company was previously exploring buying plantation land in Indonesia or Cambodia to hedge its natural rubber cost. This initiative has since been scrapped.

3.4 Supermax

Repairing its image may be at the top of the company’s to-do list. Supermax's CEO recently made "controversial statements" in the lead-up to the 13th general elections. Soon after this, EPF sold down its position in the stock and tax authorities were dispatched to the company.

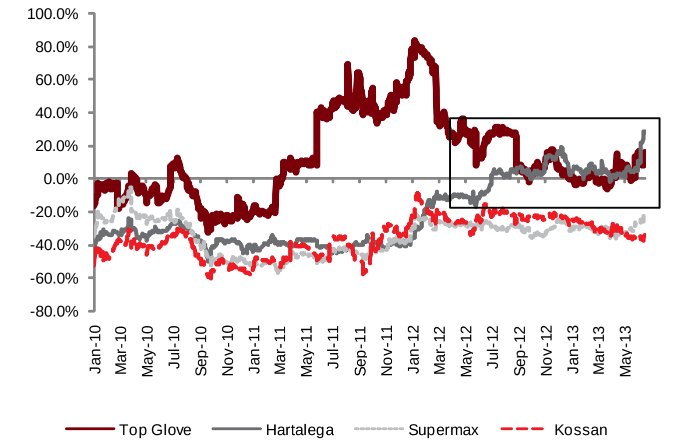
The company will also be trying to boost associate earnings from Brazil, where the contribution of associates to net profit has fallen from a peak of 50% in 2011 to 10% currently (1Q13).

4. VALUATION AND RECOMMENDATION

4.1 Changing our valuation approach

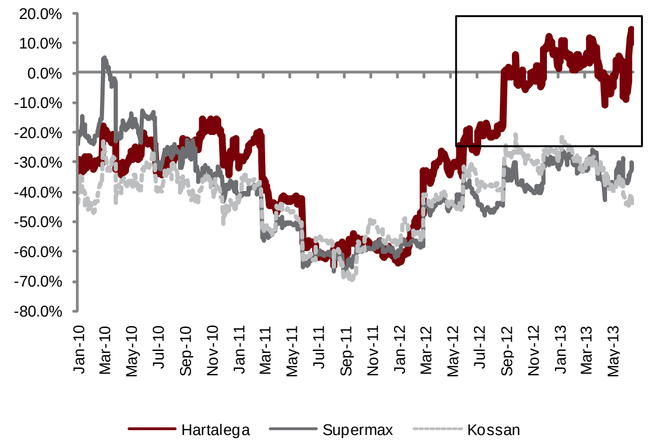
We are changing our valuation benchmark for the glove sector from Top Glove's historical P/E to the KLCI's target market P/E. While Top Glove has long been the bellwether stock in the sector by virtue of being the largest (manufacturing capacity and market capitalisation) and most liquid stock, the industry is undergoing fundamental changes where Top Glove appears to be behind the curve. Therefore, we believe using the KLCI as a benchmark will better reflect the risks and growth prospects of each glovemaker.

Figure 22: Premium/(discount) to KLCI



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 23: P/E premium/(discount) to Top Glove



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Demand for synthetic gloves is now stronger due to the enhancement of manufacturing technologies and lower production costs arising from economies of scale.

The long years that Hartalega spent in the shadows perfecting its synthetic glovemaking techniques appear to be paying off, with demand for nitrile gloves expected to rise by 20% annually compared to less than 5% for natural rubber equivalents.

Top Glove, on the other hand, appears to be a victim of its past successes. Having built up the largest capacity in the industry, some 40bn pieces p.a., Top Glove has not been able to change directions swiftly. Even though incremental manufacturing capacity is calibrated to make synthetic gloves, the sheer size of the company's existing capacity means it is still 80% reliant on natural rubber where demand is lower, lead times shorter and utilisation rates mediocre.

While Hartalega has passed Top Glove as the world's most valuable glovemaker, we believe using Hartalega as a reference point is not appropriate as its rise is a recent development.

The popularity of nitrile at the expense of natural rubber dates back to only two years ago during the 2011 commodity boom. Also, it was only in May 2013 that Hartalega overtook Top Glove's market cap for good. Hartalega is still illiquid with daily trading volume of only c.480k shares as the Kuan family owns 55.1% of the company.

4.2 Glove sector downgraded to Neutral

After taking these valuation issues into consideration, we are downgrading the glove sector to Neutral from Overweight. In the process, we downgrade Hartalega to Neutral from Outperform while maintaining our existing ratings for the other glove stocks.

We now prefer the smaller two glovemakers (Kossan and Supermax) instead of the larger two (Hartalega and Top Glove). An overview of our valuation basis is summarised in Figure 24.

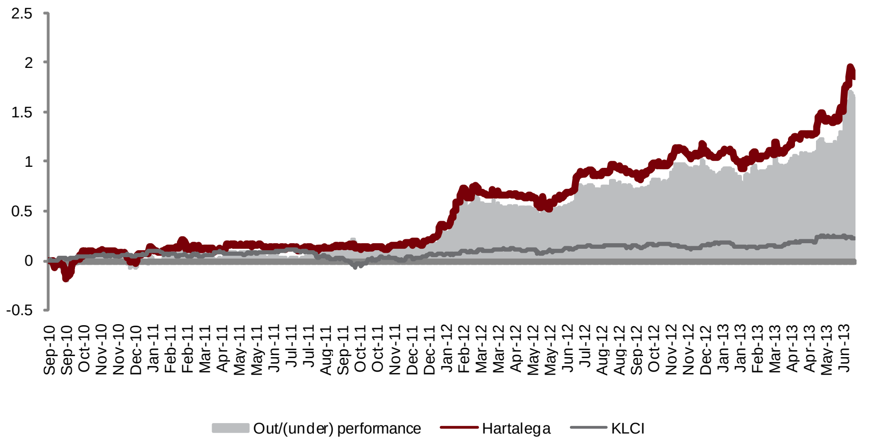
Figure 24: P/E versus the KLCI (since 1 Jan 2010)

	Average	Median	Max	Min	TP %	P/E (x)	TP (RM)	Rec
Hartalega	-22.9%	-32.3%	18.6%	-50.3%	20%	18.72	6.77	Neutral
Kossan	-36.0%	-35.2%	-9.1%	-60.4%	-15%	13.26	6.44	Outperform
Supermax	-35.2%	-31.8%	-5.7%	-57.4%	-35%	10.14	2.26	Outperform
Top Glove	12.6%	6.2%	83.1%	-32.4%	10%	17.16	6.55	Neutral

SOURCES: CIMB, COMPANY REPORTS

Hartalega has been our top pick for the past three years since Sep 2010, returning 170% and 149% in absolute and relative returns, respectively, during that period. Since we started covering the stock, Hartalega has transformed from just another glovemaker into the world's most valuable, knocking Top Glove off the top spot.

Figure 25: Hartalega's share price vs. the KLCI



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

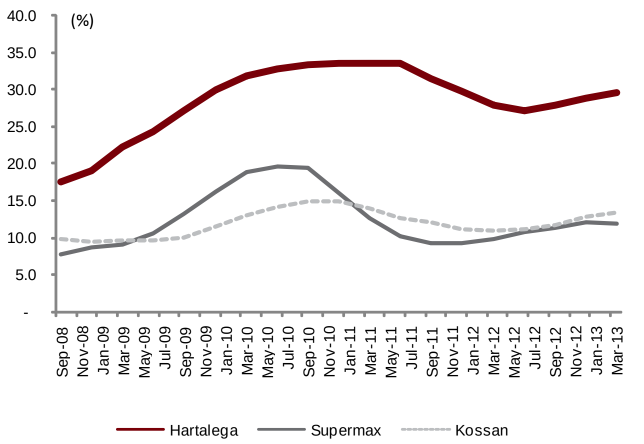
Now however, we believe the risk-reward trade-offs are less attractive as just about every glovemaker is building synthetic capacity to capture the rising demand. While the signs of overcapacity are not yet visible, we believe the risks of intense competition, price wars and idle lines are higher in 2014 when Hartalega's own NGC comes online.

Hartalega has mitigated the pressure of lower margins by optimising the weight of its synthetic gloves and upping the speed of its lines. However, we believe the low-hanging fruits of productivity gains have been harvested and further improvements will be more difficult to achieve.

We also believe Hartalega may have the most to lose as its EBIT margins are highest in the sector (Figure 26,27). While most glovemakers run their glovemaking operations at EBIT margins of between 10-15%, Hartalega's technology and cost-conscious techniques allow it to earn double that rate.

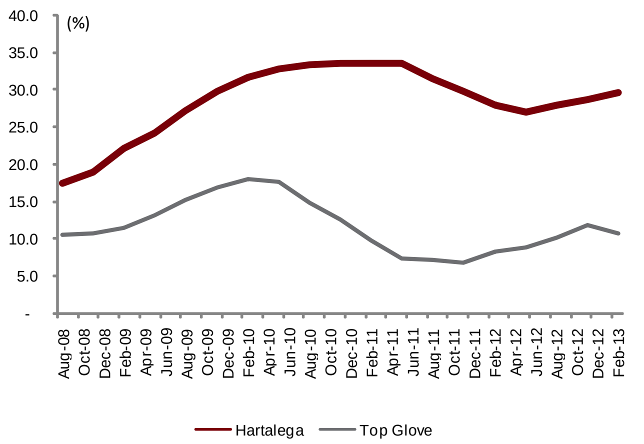
Such high profitability may not be sustainable when large amounts of capacity become operational, likely from 2014 onwards. This may lead to a normalisation of margins as Hartalega seeks to fill capacity.

Figure 26: EBIT margins, Hartalega vs. Supermax and Kossan



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 27: EBIT margins, Hartalega vs. Top Glove



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Also, we believe that the market has priced in a best-case scenario for Hartalega as we believe the market has not factored in the risk of over capacity, price competition and margin erosion in the quarters ahead.

Kossan remains an Outperform and is now the sector's top pick. Most notably, the stock's valuation remains undemanding at just 9.7x CY14 P/E compared to 16.4x for Hartalega and 16.5x for Top Gove. We also like the company's strategy to expand into the technical rubber products (TRP) segment, which will diversify earnings and boost profitability as TRP products tend to follow economic cycles.

Supermax, despite encountering turbulence after the general elections, remains attractively valued at 7.4x CY14 P/E. The company has weathered several crises in the past and we are confident that it will bounce back.

We retain our Neutral rating on Top Glove as we believe strong demand for synthetics is balanced by the company's dependence on natural rubber glove sales and the potential cannibalisation of capacity.

DOWNGRADE

CIMB

Hartalega Holdings

HART MK / HTHB.KL

Market Cap	Avg Daily Turnover	Free Float
US$1,402m	US$1.66m	32.4%
RM4,515m	RM5.32m	726.9 m shares

Current	RM6.15
Target	RM6.39
Prev. Target	RM6.11
Up/Downside	3.9%

SHORT TERM (3 MTH)	LONG TERM
TRADING BUY	OUTPERFORM
TRADING SELL	**NEUTRAL**
	UNDERPERFORM

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Share price info

Share price perf. (%)	1M	3M	12M
Relative	12.4	21.9	45.7
Absolute	10.4	27.6	54.1

Major shareholders	% held
Kuan family	55.1
BNP Paribas	7.4
EPF	5.1

Time for a break

We are less bullish on Hartalega's prospects as the market is pricing in a blue-skies scenario while ignoring the risks of overcapacity and price competition. Valuations are also expensive, yields are low and EPS growth likely mediocre. We downgrade from outperform to Neutral.

We are not outright bearish on the stock as nitrile demand is still strong, rising by 20% annually, and Hartalega is the best-managed glovemaker in our view. We now value the stock based at 18.7x CY14 P/E (from 16.8x), based on a 20% premium over our target market P/E of 15.6x (from 13.5x), in line with its historical range, which lifts its target price. We prefer Kossan instead.

What a run!

Since 2010, we have been bullish on Hartalega as the stock has been our top pick for most of this time. During this period, the share price has risen by 170%, outperforming the KLCI by 149%. The company has come a long way, from playing in the shadows to the world's most valuable glovemaker today. In May this year, Hartalega's market cap overtook Top Glove's and is now RM600m larger than its rival's. Also, since the company's 2008 IPO, quarterly earnings have risen by 4.8x, reaching more than RM60m in 4Q13 and the share price is up 12x. Nitrile imports into the US have risen 24.3% p.a. over the past nine years and Hartalega has been the primary beneficiary of this secular trend. Now more than 80% of all US glove imports are nitrile, up from only 18% in 2003. To cement its hold on the synthetic market, Hartalega will start building a 24bn-piece-p.a. plant in Sepang this Sep. This is its most ambitious plan and will be a big test for MD Kuan Mun Leong, who took over day-to-day operations from his father in Nov 2012.

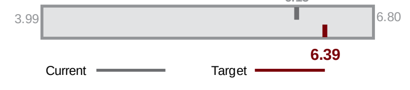
Downgrade to Neutral

Hartalega's run has been remarkable. However, we believe the market is ignoring the risk of competition as all glovemakers seem to be building nitrile capacity at full steam, with several saying they aim to be the world's biggest. Nitrile capacity could rise by 22.1% p.a. over the next eight years, outpacing historical demand growth of only 8-10%.

Expensive valuations

FY15 P/E is now 17.6x and net yield is only 2.8%, which is expensive as we expect net profit growth to be mediocre over the next two years. EPS growth would pick up in FY16 when its 24bn-piece-p.a. NGC is complete and operational.

52-week share price range



Financial Summary

	Mar-12A	Mar-13A	Mar-14F	Mar-15F	Mar-16F
Revenue (RMm)	931	1,032	1,175	1,290	1,673
Operating EBITDA (RMm)	289.2	338.7	376.0	429.6	509.7
Net Profit (RMm)	201.6	234.7	253.9	279.5	333.0
Core EPS (RM)	0.28	0.32	0.35	0.38	0.46
Core EPS Growth	7.2%	15.1%	8.2%	10.1%	19.1%
FD Core P/E (x)	21.92	20.01	19.38	17.60	14.78
DPS (RM)	0.16	0.14	0.16	0.17	0.21
Dividend Yield	2.61%	2.30%	2.56%	2.81%	3.35%
EV/EBITDA (x)	14.98	12.70	11.56	9.96	8.41
P/FCFE (x)	36.8	40.7	99.6	106.7	31.7
Net Gearing	(22.4%)	(22.2%)	(11.8%)	(14.0%)	(12.1%)
P/BV (x)	7.22	5.84	4.24	3.29	2.90
Recurring ROE	36.6%	33.9%	27.9%	23.2%	23.0%
% Change In Core EPS Estimates			0%	0%	0%
CIMB/consensus EPS (x)			1.00	1.00	1.04

SOURCE: CIMB, COMPANY REPORTS

Profit & Loss

(RMm)	Mar-13A	Mar-14F	Mar-15F	Mar-16F
Total Net Revenues	**1,032**	**1,175**	**1,290**	**1,673**
Gross Profit	**301**	**335**	**369**	**481**
Operating EBITDA	**339**	**376**	**430**	**510**
Depreciation And Amortisation	(32)	(50)	(70)	(84)
Operating EBIT	**307**	**326**	**359**	**426**
Total Financial Income/(Expense)	(0)	(9)	(10)	(10)
Total Pretax Income/(Loss) from Assoc.	0	0	0	0
Total Non-Operating Income/(Expense)	0	0	0	0
Profit Before Tax (pre-EI)	**307**	**318**	**349**	**416**
Exceptional Items	0	0	0	0
Pre-tax Profit	**307**	**318**	**349**	**416**
Taxation	(71)	(64)	(70)	(83)
Exceptional Income - post-tax	0	0	0	0
Profit After Tax	**236**	**254**	**280**	**333**
Minority Interests	(0)	(0)	(0)	(0)
Preferred Dividends	0	0	0	0
FX Gain/(Loss) - post tax				
Other Adjustments - post-tax	(1)	0	0	0
Net Profit	**235**	**254**	**280**	**333**
Recurring Net Profit	235	254	280	333
Fully Diluted Recurring Net Profit	**235**	**254**	**280**	**333**

Balance Sheet

(RMm)	Mar-13A	Mar-14F	Mar-15F	Mar-16F
Total Cash And Equivalents	182	230	290	286
Total Debtors	125	129	142	184
Inventories	87	59	64	84
Total Other Current Assets	0	0	0	0
Total Current Assets	**394**	**418**	**497**	**554**
Fixed Assets	535	889	1,118	1,275
Total Investments	0	0	0	0
Intangible Assets	7	7	7	7
Total Other Non-Current Assets	0	0	0	0
Total Non-current Assets	**542**	**896**	**1,126**	**1,282**
Short-term Debt	8	100	100	100
Current Portion of Long-Term Debt				
Total Creditors	93	88	97	125
Other Current Liabilities	15	12	11	10
Total Current Liabilities	**115**	**201**	**208**	**235**
Total Long-term Debt	4	5	0	0
Hybrid Debt - Debt Component				
Total Other Non-Current Liabilities	0	0	0	0
Total Non-current Liabilities	**4**	**5**	**0**	**0**
Total Provisions	50	53	55	58
Total Liabilities	**170**	**259**	**263**	**294**
Shareholders' Equity	766	1,055	1,359	1,542
Minority Interests	1	0	0	0
Total Equity	**767**	**1,055**	**1,359**	**1,542**

Cash Flow

(RMm)	Mar-13A	Mar-14F	Mar-15F	Mar-16F
EBITDA	338.7	376.0	429.6	509.7
Cash Flow from Invt. & Assoc.				
Change In Working Capital	35.1	18.5	(9.7)	(32.6)
(Incr)/Decr in Total Provisions				
Other Non-Cash (Income)/Expense				
Other Operating Cashflow	10.9	27.4	4.7	(2.3)
Net Interest (Paid)/Received	(0.1)	(8.6)	(9.9)	(9.6)
Tax Paid	(57.0)	(57.2)	(63.5)	(69.9)
Cashflow From Operations	**327.6**	**356.2**	**351.2**	**395.3**
Capex	(200.0)	(400.0)	(300.0)	(240.0)
Disposals Of FAs/subsidiaries	0.0	0.0	0.0	0.0
Acq. Of Subsidiaries/investments	0.0	0.0	0.0	0.0
Other Investing Cashflow	0.1	0.1	0.1	0.1
Cash Flow From Investing	**(199.9)**	**(399.9)**	**(299.9)**	**(239.9)**
Debt Raised/(repaid)	(12.5)	93.1	(5.3)	0.0
Proceeds From Issue Of Shares	0.0	150.0	150.0	0.0
Shares Repurchased	0.0	0.0	0.0	0.0
Dividends Paid	(102.9)	(114.3)	(125.8)	(149.8)
Preferred Dividends				
Other Financing Cashflow	(1.4)	(8.6)	0.0	0.0
Cash Flow From Financing	**(116.8)**	**120.2**	**19.0**	**(149.8)**

Key Ratios

	Mar-13A	Mar-14F	Mar-15F	Mar-16F
Revenue Growth	10.8%	13.9%	9.7%	29.7%
Operating EBITDA Growth	17.1%	11.0%	14.2%	18.6%
Operating EBITDA Margin	32.8%	32.0%	33.3%	30.5%
Net Cash Per Share (RM)	0.23	0.17	0.26	0.26
BVPS (RM)	1.05	1.45	1.87	2.12
Gross Interest Cover	339.7	36.6	34.8	41.9
Effective Tax Rate	23.1%	20.0%	20.0%	20.0%
Net Dividend Payout Ratio	43.8%	45.0%	45.0%	45.0%
Accounts Receivables Days	41.92	36.87	34.88	32.41
Inventory Days	45.95	31.58	24.42	22.75
Accounts Payables Days	29.10	24.98	24.42	22.75
ROIC (%)	44.1%	37.9%	27.4%	26.1%
ROCE (%)	40.6%	32.0%	26.4%	26.5%

Key Drivers

	Mar-13A	Mar-14F	Mar-15F	Mar-16F
ASP (% chg, main prod./serv.)	-6.0%	-6.9%	0.0%	0.0%
Unit sales grth (%, main prod./serv.)	26.9%	24.9%	9.7%	29.7%
Util. rate (%, main prod./serv.)	90.0%	88.0%	88.0%	88.0%
ASP (% chg, 2ndary prod./serv.)	N/A	N/A	N/A	N/A
Unit sales grth (%,2ndary prod/serv)	N/A	N/A	N/A	N/A
Util. rate (%, 2ndary prod/serv)	N/A	N/A	N/A	N/A
Unit raw mat ASP (%chg,main)	N/A	N/A	N/A	N/A
Unit raw mat ASP (%chg,2ndary)	N/A	N/A	N/A	N/A

SOURCE: CIMB, COMPANY REPORTS

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(a) Hartalega Holdings, Supermax Corp, Top Glove Corporation|

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The survey result is as of the date appearing in the Corporate Governance Report of Thai Listed Companies. As a result, the survey result may be changed after that date. CIMBS does not confirm nor certify the accuracy of such survey result.

Score Range:	90 – 100	80 – 89	70 – 79	Below 70 or	No Survey Result
Description:		Excellent	Very Good	Good	N/A

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Distribution of stock ratings and investment banking clients for quarter ended on 31 May 2013 1042 companies under coverage		
	Rating Distribution (%)	Investment Banking clients (%)
Outperform/Buy/Trading Buy	52.1%	7.6%
Neutral	34.2%	4.9%
Underperform/Sell/Trading Sell	13.7%	5.5%

Recommendation Framework #1 *

Stock

OUTPERFORM: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 12 months.

NEUTRAL: The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

TRADING SELL: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 3 months.

Sector

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

TRADING BUY: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 3 months.

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

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

CIMB Research Pte Ltd (Co. Reg. No. 198701620M)

Recommendation Framework #2 **

Stock

OUTPERFORM: Expected positive total returns of 10% or more over the next 12 months.

NEUTRAL: Expected total returns of between -10% and +10% over the next 12 months.

UNDERPERFORM: Expected negative total returns of 10% or more over the next 12 months.

TRADING BUY: Expected positive total returns of 10% or more over the next 3 months.

TRADING SELL: Expected negative total returns of 10% or more over the next 3 months.

Sector

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of +10% or better over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, has either (i) an equal number of stocks that are expected to have total returns of +10% (or better) or -10% (or worse), or (ii) stocks that are predominantly expected to have total returns that will range from +10% to -10%; both over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of -10% or worse over the next 12 months.

TRADING BUY: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of +10% or better over the next 3 months.

TRADING SELL: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of -10% or worse over the next 3 months.

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Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (IOD) in 2012.

AAV – not available, **ADVANC** - Excellent, **AEONTS** – Good, **AMATA** - Very Good, **ANAN** – not available, **AOT** - Excellent, **AP** - Very Good, **BANPU** - Excellent , **BAY** - Excellent , **BBL** - Excellent, **BCH** – not available, **BCP** - Excellent, **BEC** - Very Good, **BGH** - not available, **BJC** – Very Good, **BH** - Very Good, **BIGC** - Very Good, **BTS** - Excellent, **CCET** - Good, **CENTEL** – Very Good, **CK** - Very Good, **CPALL** - Very Good, **CPF** - Very Good, **CPN** - Excellent, **DELTA** - Very Good, **DTAC** - Very Good, **EGCO** – Excellent, **ERW** – Excellent, **GLOBAL** - Good, **GLOW** - Very Good, **GRAMMY** – Excellent, **HANA** - Very Good, **HEMRAJ** - Excellent, **HMPRO** - Very Good, **INTUCH** – Very Good, **ITD** – Very Good, **IVL** - Very Good, **JAS** – Very Good, **KAMART** – not available, **KBANK** - Excellent, **KK** – Excellent, **KTB** - Excellent, **LH** - Very Good, **LPN** - Excellent, **MAJOR** - Good, **MAKRO** – Very Good, **MCOT** - Excellent, **MINT** - Very Good, **PS** - Excellent, **PSL** - Excellent, **PTT** - Excellent, **PTTGC** - Excellent, **PTTEP** - Excellent, **QH** - Excellent, **RATCH** - Excellent, **ROBINS** - Excellent, **RS** – Excellent, **SAMART** – Excellent, **SC** – Excellent, **SCB** - Excellent, **SCC** - Excellent, **SCCC** - Very Good, **SIRI** - Good, **SPALI** - Very Good, **SRICHA** – not available, **SSI** – not available, **STA** - Good, **STEC** - Very Good, **TCAP** - Very Good, **THAI** - Excellent, **THCOM** – Very Good, **TICON** – Very Good, **TISCO** - Excellent, **TMB** - Excellent, **TOP** - Excellent, **TRUE** - Very Good, **TTW** – Very Good, **TUF** - Very Good, **VGI** – not available, **WORK** – Good.