

# Malaysia Industry Focus

## Rubber Gloves

DBS Group Research . Equity

28 Sep 2011

### Stronger earnings pressure

- Facing same challenges as in 2008, but greater earnings risk in 2011
- Cut FY11-13F earnings on higher nitrile and natural gas costs, and toned down margins
- Maintain Buy for Hartalega; Hold Kossan (downgrade) and Top Glove

**Greater earnings risk in 2011 due to higher latex prices.** Glove makers are seeing a repeat of 2008 as higher raw material and energy costs and weaker USD/RM take their toll on earnings. 2008 earnings growth moderated to 21% from 34% in 2007, but operating margins were healthy as demand was robust and cost increases were passed on to customers. In 2011, we are seeing more severe cost pressure and glove makers are finding it difficult to pass on costs partly because prolonged de-stocking (from mid-2010 to early 2011) softened glove demand. There is greater earnings risk in 2011 due to higher natural rubber (NR) and nitrile latex prices and time lag in passing on costs. We expect earnings to fall 13% in 2011 while operating margins to decline to c.13%. If raw material prices continue to rise, we expect further pressure on margins.

**Demand to drive growth, albeit weaker.** Medical glove usage in the healthcare industry (which accounts for 75-80% of total glove consumption) is resilient. We see weak correlation between glove demand and GDP growth. The US, which is the largest glove importer (35% of global imports), has been seeing an uptrend in total healthcare expenditure as % of GDP since 2000. The UK and major European countries are experiencing similar trends, and we expect other countries to raise their hygiene standards eventually. We expect capacity growth to normalise to 8-10% in the next two years. That said, future earnings growth will be less exciting with latex prices expected to remain high, although easing slightly.

**Cut FY11-13F earnings** for glove makers by 3-25% to account for higher nitrile latex and gas costs, which resulted in lower margins. Our NR latex price assumptions are unchanged. Valuations are now at mean levels, compared to -1SD in 2008. We maintain a Buy rating for Hartalega (revised TP RM6.50) and Hold for Top Glove (revised TP RM4.05). We downgrade Kossan to Hold (revised TP RM2.70) on weaker earnings outlook.

KLCI : 1,331.80

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#### Stock Coverage

	Price RM	Mkt Cap US\$m	Target Price RM	Rating
Top Glove	4.01	780	4.05	HOLD
Hartalega	5.45	623	6.50	BUY
Kossan Rubber	2.56	257	2.70	HOLD

Prices at 26 Sep 2011

Source: DBS Vickers

**Top Glove Corporation :** The world's largest rubber glove maker with capacity for 34b gloves or 23% market share. It produces 80% natural rubber gloves and 20% nitrile, vinyl and surgical gloves.

**Hartalega Holdings Berhad :** The most efficient glove maker with the highest operating margins and ROEs among peers. It has capacity for 9.6b gloves or 6% market share, and is the largest nitrile glove maker.

**Kossan Rubber Industries :** Kossan has capacity for 12b gloves or 8% market share. It manufactures a balanced mix of 40% nitrile, 40% powder-free and 20% powdered gloves.

#### Net profit trends (YoY)

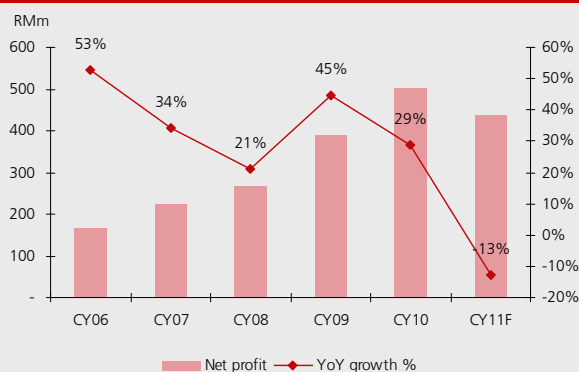


Chart here refers to net profit of glove companies in our universe.

Source: Companies

#### Peer comparison

	Beta	Foreign sholding	YTD return	Net cash/(debt) RMm
Top Glove	0.81	35%	-19%	137
Hartalega	0.76	10%	5%	100
Kossan	0.99	9%	-17%	-62

Source: Companies, Bloomberg

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## Rubber Gloves Sector: Now vs. 2008

2008 Global Financial Crisis	2011 US/Europe concerns	DBSV view/outlook
<b>Earnings</b>		
Earnings growth moderated to 21% from 34% in 2007 due to (i) rising raw material costs, (ii) higher natural gas costs, and (iii) weaker USD/RM. Earnings continued to grow as glove makers were able to pass on cost increases to customers in a timely manner.	We expect earnings to contract by 13% in 2011. Like in 2008, rising raw material and natural gas costs, coupled with weak USD/RM are compressing earnings, but this time, we expect earnings to contract because the cost increases are more severe.	Glove usage in the healthcare industry (75-80% of total glove consumption) is resilient. We see weak correlation between glove demand and GDP growth, but earnings growth would be less exciting due to cost and currency headwinds.
<b>Operating Margins</b>		
Operating margins were intact as demand was robust and cost increases were passed on to customers effectively. In fact, operating margins improved to 13% in 2008 from 12% in 2007.	Operating margins remain under pressure as glove makers are finding it difficult to pass on cost increases to customers, partly due to the prolonged de-stocking (from mid-2010 to early 2011) which softened glove demand.	We expect operating margins to average c.13% in 2011. If raw material (NR and nitrile) prices continue to rise, there will be further pressure on margins. We are retaining FY11-13F NR latex price assumptions of RM8.80-8.10/kg, but raised nitrile latex prices to RM5.30/kg from RM4.70/kg.
<b>Balance sheet strength</b>		
Gearing levels were low. Top Glove's net gearing was 0.1x, Kossan 0.7x, and Hartalega 0.2x.	Top Glove and Hartalega are in net cash positions, while Kossan's net gearing is low at 0.1x.	A strong balance sheet would help glove makers to ride through current cost pressures.
<b>Capacity expansion</b>		
Capacity grew 12% in 2008. In 2009, an unexpected surge in glove demand (because of H1N1 outbreak) drove more aggressive expansion plans. However, they were either delayed or toned down following de-stocking in mid-2010.	We expect Top Glove to expand at a moderate pace given its low utilisation rate (70-75%). There is still room for double digit growth at Kossan and Hartalega, as both are operating at 80-90% utilisation.	We expect capacity to grow at normalised rate of 8-10% p.a.
<b>Valuation</b>		
Valuations were depressed to -1SD (PE and PBV) due to expectations of a tough operating environment.	Glove makers face similar costs and currency headwinds, and valuations have fallen from +1SD to mean.  Top Glove and Kossan are now trading at mean, while Hartalega at +1SD.	If market conditions continue to worsen, our bear case scenario shows that Top Glove and Kossan's valuations could trade at between mean and -1SD, and Hartalega at between +1SD and mean.

Source: DBS Vickers

## Base case vs Bear case TP scenarios

	Share Price as at 26 Sep (RM/sh)	Base TP (RM/sh)	Base case basis PE (x)	% upside to base case	Bear TP (RM/sh)	Bear case basis PE(x)	Implied PE trading band	% downside to bear case
Top Glove	4.01	4.05	13.5x	1%	3.00	10.0x	-0.5SD	-25%
Hartalega	5.45	6.50	11.0x	19%	4.70	8.0x	+0.5SD	-14%
Kossan	2.56	2.70	7.5x	5%	2.15	6.0x	-0.5SD	-16%

Source: Bloomberg, DBS Vickers

## Stronger earnings pressure

## Challenges faced by glove makers now are similar to 2008.

They are (i) rising raw material costs, (ii) higher energy costs, and (iii) weaker USD vs RM. In 2008, net profit growth decelerated to 21% from 34% and 53% in the previous two years, but this was due to costs and currency headwinds rather than slower GDP growth. Indeed, there is weak correlation between healthcare spending and GDP growth. The use of medical gloves remained resilient due to safety and hygiene requirements in the healthcare industry. Similarly in 2011, glove makers are again facing a cycle of record high latex prices and weak USD/RM. But this time, we expect earnings to decline by 13% as latex prices have risen more rapidly and were volatile, making it difficult for glove makers to implement the cost pass through mechanism. Furthermore, it is taking a longer time to pass on costs due to post H1N1 de-stocking activity. The de-stocking, which started in 2H 2010 and spilled over to early 2011, had softened glove demand. As a result, glove makers are absorbing some of the costs increases.

## Malaysia: Glove makers - earnings trend (YoY)

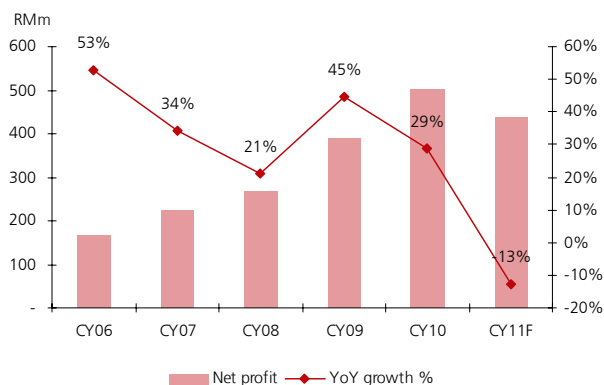


Chart here refers to net profit of glove companies in our universe.

Source: Companies, DBS Vickers

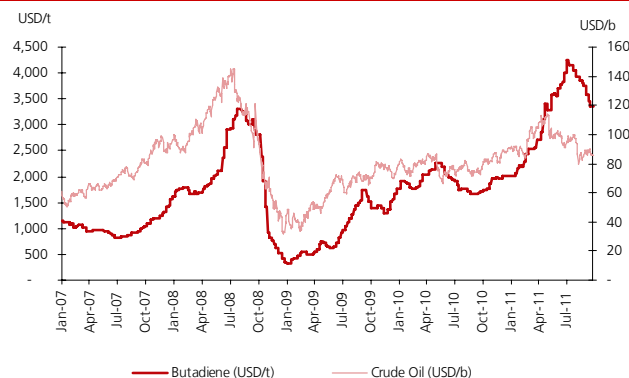
**The culprits are high latex prices and weak USD/RM.** Raw material cost (NR and nitrile latex) comprise c.60% of total production costs and is the main component that could swing profitability and margins. The USD is the main trading currency for over 90% of exports. Glove makers usually incorporate increases in latex costs or currency movements to the following month's selling prices. The key is the ability to pass on cost increases in a timely manner.

## Natural rubber (NR) latex prices trend



Source: Bloomberg

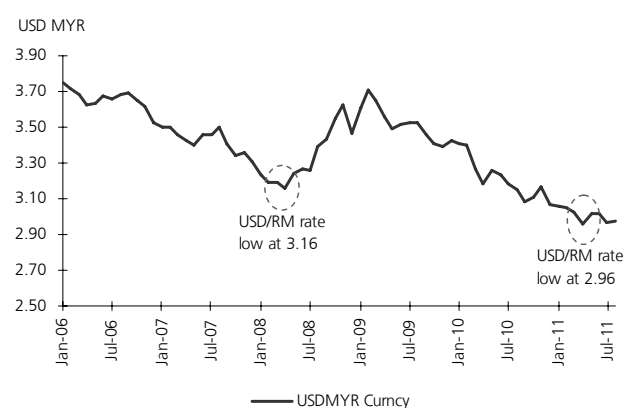
## Butadiene price trend



Nitrile latex is made from nitrile butadiene, acrylonitrile and other chemicals. We use butadiene as a proxy to nitrile latex price.

Source: Bloomberg

## Currency trends (USD/RM)



Source: Bloomberg

**Sensitivity of raw material price movements to earnings.** We are retaining our FY11-13 assumptions for NR latex prices (RM8.80-8.10/kg), but raised nitrile latex prices to RM5.30/kg from RM4.70/kg. Nitrile latex is made from nitrile butadiene, acrylonitrile and other chemicals. Butadiene is a by-product of crude oil, so its prices track crude prices closely. However, nitrile latex prices remain high despite butadiene prices easing since Jul-11. We believe this is due to strong demand for nitrile latex as glove makers had been progressively raising production of nitrile gloves in 2011. Based on our sensitivity analysis, every 1% increase in raw material costs would reduce net profit by 2-4%.

#### Sensitivity Analysis: Earnings vs 1% increase in raw material costs

	FY12 net profit	Sensitised net profit	Earnings % chg	% raw material cost to total
Top Glove	176	169	-3.7%	62%
Hartalega	202	199	-1.8%	68%
Kossan	114	109	-4.4%	60%
	492	477	-3.1%	

Source: Companies, DBS Vickers

**Sensitivity of energy costs to earnings.** Energy costs account for 8-11% of glove makers' total production costs. They comprise 60-70% natural gas and 30-40% biomass and electricity. Effective Jun-11, the government raised gas price to RM16.07 per mmbtu (+7%) from RM15 per mmbtu, and there will be 8-19% increase in gas price every 6 months until 2015. Our sensitivity analysis shows that each 1% increase in energy cost would reduce net profit by c.0.5%.

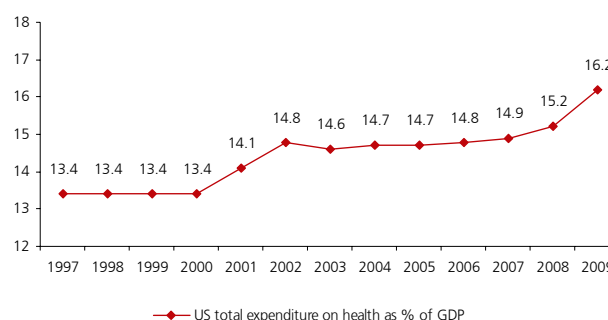
#### Sensitivity Analysis: Earnings vs 1% increase in energy costs

	FY12 net profit	Sensitised net profit	Earnings % chg	% raw material cost to total
Top Glove	176	175	-0.5%	9%
Hartalega	202	202	-0.2%	8%
Kossan	114	113	-0.9%	11%
	492	490	-0.5%	

Source: Companies, DBS Vickers

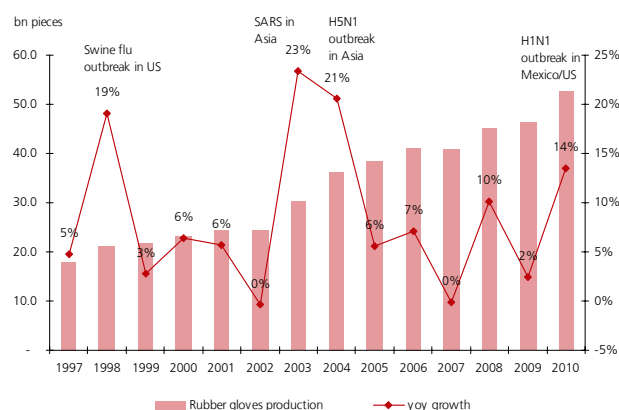
**Sustainable demand to support industry growth.** Demand for rubber gloves in the medical industry is relatively resilient. We used the US's total healthcare expenditure as % of GDP to proxy glove demand, given that the US is the largest glove importer (c.35% of global imports). We note that the US healthcare expenditure share has been rising since 2000, which supports our view of resilient medical glove demand and weak correlation to GDP growth. Similar trends were spotted in the UK and major European countries. We expect developing countries such as China and India to eventually follow this trend as they gradually raise hygiene and healthcare standards. Flu and disease outbreaks in the recent two decades have raised awareness and new demand for gloves in the medical industry. The practice of using gloves as a protective barrier is usually continued once started, and hence, the new demand created should be sustainable.

#### US: Total expenditure on healthcare as % of GDP



Source: World Health Organisation (WHO)

#### Malaysia: Rubber gloves production



Source: Bank Negara Malaysia

**Pressure in operating margins.** Operating profit margins had been rising since 2006 due to booming glove demand, riding on increasing awareness of high hygiene standards in medical practice, and new markets opened up in Latin America, Eastern Europe, the Middle East and Asia. A structural change in Brazil's healthcare regulation caused an influx of demand for medical grade rubber gloves in the country in 2008. Operating profit margins scaled to record highs in 2009-2010 (c.17%) as the H1N1 flu outbreak caused a spike in demand for medical gloves in hospitals. The outbreak started in mid-2009 in Mexico, and quickly spread around the world. However, de-stocking post-H1N1, coupled with higher raw material and energy costs, dragged down operating margins to c.13% in 2011. This is relatively close to pre-H1N1 levels. Going forward, if latex and nitrile prices continue to rise, we expect margins to be compressed further.

#### Malaysia: Operating profit margin trend

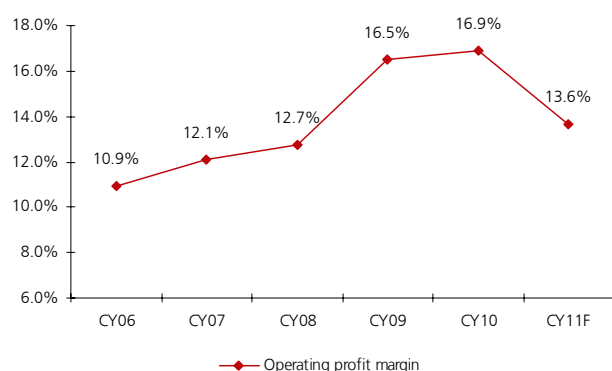
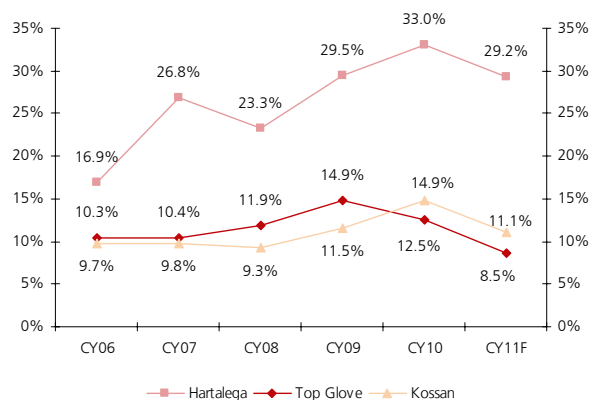


Chart here represents operating profit margin of glove companies in our universe only.

Source: Companies

#### Operating profit margin trend by company



Source: Companies

**Stronger balance sheets now.** All three glove makers under our coverage are operating on stronger balance sheets now compared to 2008. Inventories and debtor turnover periods average 2-3 months, while annual capacity expansion is between RM50-150m. Top Glove and Hartalega are both in net cash positions, at 22 sen per share (as at May-11) and 27 sen per share (as at Jun-11), respectively. Meanwhile, Kossan's net gearing was reduced from 0.7x in 2008 to 0.1x as at Jun-11. We believe the strong balance sheets will help the glove makers to ride through the current tough operating environment.

#### Net (debt)/cash

RM(mil)	FY08	FY09	FY10	*Latest Qtr in 2011
Top Glove	(65)	177	259	134
Hartalega	(33)	(19)	33	100
Kossan	(211)	(161)	(69)	(62)

\* Refers to Jun-11 for Hartalega and Kossan; May-11 for Top Glove.

Source: Companies

**Capacity expansion.** Between 2008 and now, capacity expansion has been stable, growing at 10-12% annually. During the 2009 H1N1 outbreak, the unexpected surge in glove demand drove most glove makers in the industry to expand more aggressively. However, most plans were delayed or toned down when distributors and hospitals started de-stocking in mid-2010. In the next two years, we expect Top Glove to grow capacity at a moderate pace (7-8% YoY) as it is currently operating at 70-75% utilisation. We forecast Kossan's capacity will grow 10-12% and Hartalega at 18-20%. Both companies are operating at 80-90% utilization now.

#### Production Capacity

Bn pieces	CY07	CY08	CY09	CY10	CY11F	CY12F
Top Glove	28.7	30.5	33.0	36.3	39.1	41.9
Hartalega	3.6	5.1	6.3	7.6	9.2	10.8
Kossan	6.5	7.9	9.3	9.3	10.3	11.5
<b>Total</b>	<b>38.9</b>	<b>43.4</b>	<b>48.6</b>	<b>53.2</b>	<b>58.6</b>	<b>64.2</b>
YoY % increase	26%	12%	12%	10%	10%	10%

Source: Companies

## Valuation and recommendation

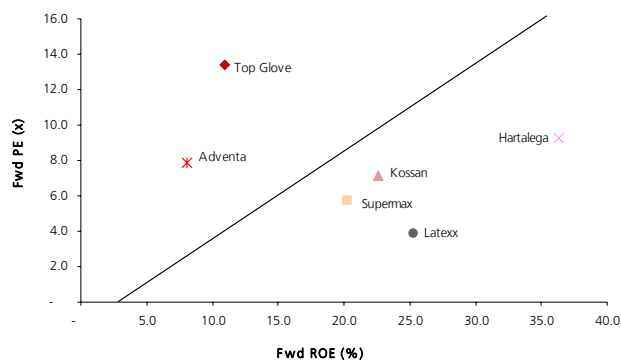
**Valuations testing trough levels?** In 2008, valuations were depressed to -1SD due to negative sentiment amid a tougher operating environment. In 2011, glove makers are facing similar costs and currency headwinds. Top Glove and Kossan are now trading at mean levels, while Hartalega at +1SD. If market conditions continue to worsen, our bear case scenario shows that Top Glove and Kossan's valuations could trade between mean and -1SD, and Hartalega's between +1SD and mean.

**Top Glove's foreign shareholders might sell down.** Top Glove's foreign shareholding is currently 35% (highest in 2011) vs 33% three months ago and 31% in early 2011. There could be sell down pressure if market conditions continue to worsen. We do not see risk of foreign shareholders selling down in Kossan and Hartalega because they are small at 9-10%.

**Earnings recovery not in sight for Top Glove (Maintain HOLD).** We cut FY11-13F net profit by 9-25% because we had been too bullish on its earnings momentum earlier. We now assume lower operating profit (EBIT) margins of 8-10% (from 9-13% previously), which mirrors normalised levels, ex-H1N1 impact. As a result, our target price is lowered to RM4.05 (from RM5.30) based on 13x CY12 EPS.

**Hartalega remains our top pick (Maintain BUY).** Hartalega is the leader in nitrile gloves, and will continue to have strong pricing power despite competition. Among peers, it registers the highest operating margins (28% vs 16% industry average) and ROE (36% vs 22% industry average). However, in view of higher nitrile and gas costs, we trimmed FY13-14F net profit by 3-6%. No change to FY12F numbers as the 5-6% potential upside to our earnings forecast (1QFY12 earnings were higher-than-expected) would be sufficient to offset any costs uptick in FY12. We maintain a Buy rating for Hartalega, but cut target price to RM6.50 (from RM6.90) after pegging CY12 EPS to lower PE multiple of 11x against 12x previously.

## Hartalega: Most attractive ROE-PE matrix



Source: Bloomberg, Companies, DBS Vickers

**Downgrade Kossan to HOLD (from BUY).** Despite Kossan's balanced product mix (40% nitrile, 40% powder free latex, and 20% powdered latex gloves) supporting margins, its earnings will not be spared from the costs and currency headwinds. Hence, we trimmed FY11-13F net profit by 3-12%, and consequently, cut target price to RM2.70 (from RM3.50) pegged to 7.5x FY12 EPS after lowering our PE multiple (from 8.5x) to reflect a weaker earnings outlook.

## Operating matrix for local glove manufacturers

Company	FYE	Revenue (RMm)		EBIT (RMm)		Net Profit (RMm)		EBIT margin		Net profit margin	
		FY09	FY10	FY09	FY10	FY09	FY10	FY09	FY10	FY09	FY10
Top Glove	Aug	1,529	2,079	229	307	169	245	15.0%	14.7%	11.1%	11.8%
Supermax	Dec	815	923	132	148	130	168	16.3%	16.1%	15.9%	18.2%
Kossan Rubber	Dec	837	1,048	97	156	67	119	11.5%	14.9%	8.0%	11.4%
Hartalega*	Mar	572	735	180	246	143	190	31.5%	33.4%	25.0%	25.9%
Adventa	Oct	283	336	39	36	17	36	13.8%	10.8%	6.0%	10.7%
Latexx	Dec	328	497	59	91	52	70	17.8%	18.2%	15.9%	14.1%

\* Refers to FY10 and FY11 as Hartalega's FYE is March.

Source: Bloomberg, DBS Vickers

## Peer comparison

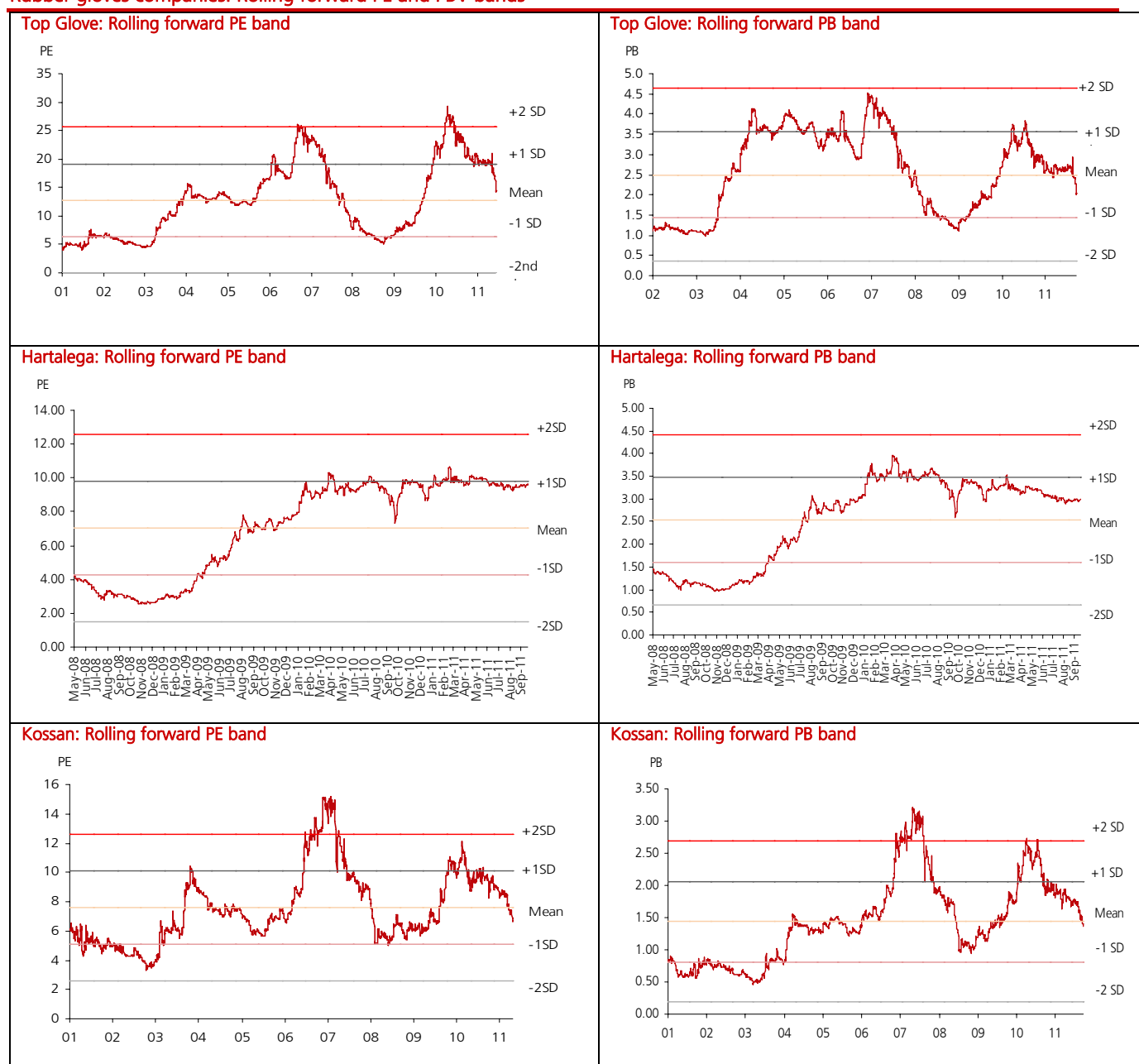
Company	Share Price (RM)	Market Cap (US\$m)	Average daily trading value (US\$m)		PE (x)		P/BV CY11(x)	Div Yield (%)	ROE (%)	ROA (%)
					CY10	CY11				
Top Glove	4.01	814.7	2.30		12.1	17.6	2.2	2.9	11	11
Hartalega	5.45	651.3	0.81		11.1	9.9	3.2	4.5	36	37
Kossan Rubber	2.56	268.9	0.54		6.9	8.3	1.5	3.6	23	14
Supermax	2.36	263.6	1.55		4.8	6.6	1.2	3.6	20	16
Latexx Partners	1.19	87.1	0.41		3.6	4.0	1.1	6.7	25	19
Adventa	1.50	75.3	0.19		6.8	10.8	0.9	4.5	8	4
<b>Simple Average</b>					<b>7.5</b>	<b>9.5</b>	<b>1.7</b>	<b>4.3</b>	<b>21</b>	<b>17</b>

Prices at 26 Sep 2011

Source: Bloomberg, DBS Vickers



Rubber gloves companies: Rolling forward PE and PBV bands



Source: Bloomberg; Companies

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## Stock Profiles

## Industry Focus

# Top Glove Corporation

Bloomberg: TOPG MK | Reuters: TPGC.KL

**HOLD RM4.01** KLCI : 1,331.80

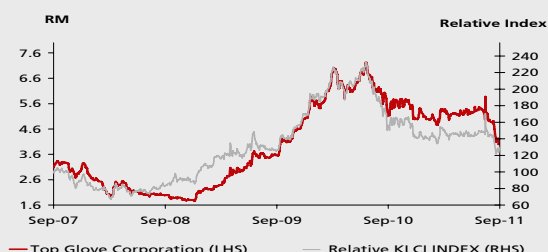
Price Target : 12-Month RM 4.05 (Prev RM 5.30)

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### Price Relative



### Forecasts and Valuation

FY Aug (RM m)	2010A	2011F	2012F	2013F
Turnover	2,079	2,035	2,309	2,565
EBITDA	364	222	295	336
Pre-tax Profit	305	166	236	274
Net Profit	245	123	176	204
Net Pft (Pre Ex.)	245	123	176	204
EPS (sen)	39.7	20.0	28.4	33.0
EPS Pre Ex. (sen)	39.7	20.0	28.4	33.0
EPS Gth (%)	45	(50)	42	16
EPS Gth Pre Ex (%)	45	(50)	42	16
Diluted EPS (sen)	39.7	20.0	28.4	33.0
Net DPS (sen)	16.0	10.0	11.4	13.2
BV Per Share (sen)	176.9	186.9	204.0	223.4
PE (X)	10.1	20.1	14.1	12.2
PE Pre Ex. (X)	10.1	20.1	14.1	12.2
P/Cash Flow (X)	11.6	13.3	12.0	10.2
EV/EBITDA (X)	6.0	9.6	6.9	5.8
Net Div Yield (%)	4.0	2.5	2.8	3.3
P/Book Value (X)	2.3	2.1	2.0	1.8
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	25.6	11.0	14.6	15.4
Earnings Rev (%):	(8.8)	(24.9)	(20.0)	
Consensus EPS (sen):	20.7	30.1	34.9	
Other Broker Recs:	B: 4	S: 12	H: 6	

ICB Industry : Health Care

ICB Sector: Health Care Equipment & Servic

Principal Business: Latex examination, nitrile and vinyl glove manufacturer

Source of all data: Company, DBS Vickers, Bloomberg

## Recovery not in sight

- **Persistent cost headwinds; earnings recovery to take longer-than-expected**
- **Slashed FY11-13F EPS by 9-25%**
- **Maintain Hold, cut TP to RM4.05 pegged to 13x PE**

**4QFY11 result preview.** Top Glove is expected to announce 4QFY11 result on 11-Oct. We expect net profit to come in at RM26-36m, taking full year FY11 profit to RM113-123m. Top Glove will benefit from easing latex prices in the quarter, as average latex prices has fallen 11% QoQ to RM8.90/kg in 4QFY11 (Jun-Aug) from RM9.90/kg in 3QFY11 (Mar-May)

**Cut FY11-13F EPS by 9-25%.** We had been too bullish on Top Glove's earnings momentum earlier. We now reduce operating profit (EBIT) margin to 8-10% (from 9-13% previously), which mirrors normalised levels, ex-H1N1 impact. During the H1N1 outbreak, EBIT margins soared to a high of 15% following an unexpected surge in demand. Going forward, we expect EBIT margins to improve from current low (3QFY11: 6.4%) as Top Glove progressively raises its share of nitrile gloves which yield higher margin. We are retaining our FY11-13 assumptions for natural rubber (NR) latex prices of RM8.10-8.80/kg. NR latex prices remained stubbornly high at RM8.50-8.90/kg in the last three months although wintering season ended in Jun-11.

**Maintain Hold; cut TP to RM4.05.** After our earnings downgrade, we cut target price to RM4.05 (from RM5.30) pegged to 13x CY12 EPS. No change to target multiple, which is equivalent to Top Glove's 10-year historical mean. We maintain our Hold rating as earnings recovery will take longer-than-expected, given the tougher operating environment with higher raw material and energy costs. Capacity utilisation averaged 70-75% this year.

### At A Glance

Issued Capital (m shrs)	619
Mkt. Cap (RMm/US\$m)	2,480 / 780
Major Shareholders	
Lim Wee Chai (%)	35.0
Overlook Partners (%)	5.0
Matthew Int Cap (%)	5.3
Free Float (%)	54.7
Avg. Daily Vol.('000)	655

## Key Assumptions

FY Aug	2009A	2010A	2011F	2012F	2013F
Capacity (bil pcs)	31.9	35.3	38.1	40.9	43.7
Utilization Rates (%)	78.0	88.0	70.0	75.0	78.0
NR latex (RM/kg)	4.3	6.5	8.8	8.3	8.1

## Sensitivity Analysis

	2012
Raw material cost +/- 1%	Net Profit +/- 3.7%
Energy cost +/- 1%	Net Profit +/- 0.5%

## Segmental Breakdown

FY Aug	2009A	2010A	2011F	2012F	2013F
<b>Revenues (RM m)</b>					
Malaysia	1,217	1,680	1,650	1,913	2,146
Thailand	127	207	202	215	222
China	104	87	66	64	79
Others	82	106	117	117	117
<b>Total</b>	<b>1,529</b>	<b>2,079</b>	<b>2,035</b>	<b>2,309</b>	<b>2,565</b>
<b>EBIT (RM m)</b>					
Malaysia	189	277	129	188	220
Thailand	33	37	16	21	23
China	9	(7)	5	6	8
Others	(2)	0	9	11	12
<b>Total</b>	<b>229</b>	<b>307</b>	<b>159</b>	<b>227</b>	<b>263</b>

With on going capacity expansion, utilization should remain below 80%

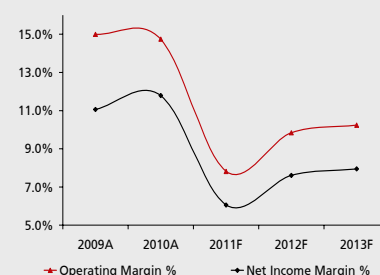
Maintain our natural rubber (NR) latex price assumptions

## Income Statement (RM m)

FY Aug	2009A	2010A	2011F	2012F	2013F
Revenue	1,529	2,079	2,035	2,309	2,565
Cost of Goods Sold	(1,156)	(1,641)	(1,755)	(1,942)	(2,146)
<b>Gross Profit</b>	<b>373</b>	<b>439</b>	<b>280</b>	<b>367</b>	<b>419</b>
Other Opng (Exp)/Inc	(144)	(132)	(121)	(139)	(156)
<b>Operating Profit</b>	<b>229</b>	<b>307</b>	<b>159</b>	<b>227</b>	<b>263</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	(1)	(1)	(1)	(1)	(1)
Net Interest (Exp)/Inc	(6)	(1)	8	10	12
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>222</b>	<b>305</b>	<b>166</b>	<b>236</b>	<b>274</b>
Tax	(54)	(55)	(40)	(57)	(66)
Minority Interest	1	(5)	(3)	(4)	(4)
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>169</b>	<b>245</b>	<b>123</b>	<b>176</b>	<b>204</b>
Net Profit before Except.	169	245	123	176	204
EBITDA	285	364	222	295	336
<b>Growth</b>					
Revenue Gth (%)	11.0	36.0	(2.1)	13.4	11.1
EBITDA Gth (%)	46.1	27.9	(39.1)	33.0	13.7
Opg Profit Gth (%)	62.2	33.7	(48.1)	42.9	15.6
Net Profit Gth (%)	53.7	45.0	(49.7)	42.4	16.1
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	24.4	21.1	13.8	15.9	16.3
Opg Profit Margin (%)	15.0	14.7	7.8	9.8	10.2
Net Profit Margin (%)	11.1	11.8	6.1	7.6	7.9
ROAE (%)	22.6	25.6	11.0	14.6	15.4
ROA (%)	15.2	19.7	8.4	10.8	11.5
ROCE (%)	19.2	24.5	10.2	13.5	14.2
Div Payout Ratio (%)	39.3	40.3	50.0	40.0	40.0
Net Interest Cover (x)	36.4	480.5	NM	NM	NM

Source: Company, DBS Vickers

## Margins Trend



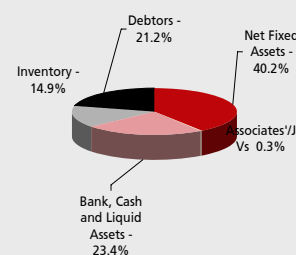
We expect operating margins to revert to normalized levels of 8-10% in FY12-13F. Top Glove's effort to expand to higher margin products (nitrile gloves) could drive margin recovery in FY12-13.

## Top Glove Corporation

## Balance Sheet (RM m)

FY Aug	2009A	2010A	2011F	2012F	2013F
Net Fixed Assets	579	603	589	570	546
Invt in Associates & JVs	9	5	4	3	2
Other LT Assets	23	20	20	20	20
Cash & ST Invt	197	303	382	474	591
Inventory	119	168	218	242	267
Debtors	176	247	311	353	392
Other Current Assets	9	26	26	26	26
<b>Total Assets</b>	<b>1,112</b>	<b>1,372</b>	<b>1,550</b>	<b>1,687</b>	<b>1,844</b>
ST Debt	11	1	1	1	1
Other Current Liab	210	218	327	350	375
LT Debt	10	3	8	13	18
Other LT Liabilities	33	34	34	34	34
Shareholder's Equity	827	1,093	1,154	1,260	1,382
Minority Interests	21	24	26	30	34
<b>Total Cap. &amp; Liab.</b>	<b>1,112</b>	<b>1,372</b>	<b>1,550</b>	<b>1,687</b>	<b>1,844</b>
Non-Cash Wkg. Capital	95	223	228	270	310
Net Cash/(Debt)	177	300	374	460	572
Debtors Turn (avg days)	47.0	37.2	50.0	52.4	53.0
Creditors Turn (avg days)	48.4	32.3	34.4	43.9	44.0
Inventory Turn (avg days)	46.0	33.1	41.6	44.8	44.8
Asset Turnover (x)	1.4	1.7	1.4	1.4	1.5
Current Ratio (x)	2.3	3.4	2.9	3.1	3.4
Quick Ratio (x)	1.7	2.5	2.1	2.4	2.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	(0.2)	(0.3)	(0.3)	(0.4)	(0.4)
Capex to Debt (%)	328.0	2,372.7	583.7	368.6	269.3
Z-Score (X)	8.8	10.7	7.7	7.8	7.6

## Asset Breakdown

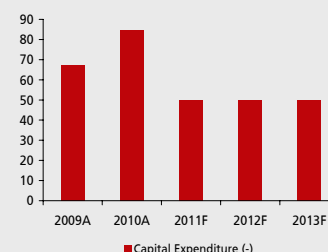


Strong net cash position to support future expansion plans

## Cash Flow Statement (RM m)

FY Aug	2009A	2010A	2011F	2012F	2013F
Pre-Tax Profit	222	305	166	236	274
Dep. & Amort.	57	59	64	69	75
Tax Paid	(39)	(74)	(40)	(57)	(66)
Assoc. & JV Inc/(loss)	1	1	1	1	1
Chg in Wkg.Cap.	67	(89)	(5)	(42)	(40)
Other Operating CF	20	11	0	0	0
<b>Net Operating CF</b>	<b>327</b>	<b>213</b>	<b>185</b>	<b>207</b>	<b>244</b>
Capital Exp.(net)	(67)	(85)	(50)	(50)	(50)
Other Invt.(net)	0	(28)	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	0	(5)	0	0	0
<b>Net Investing CF</b>	<b>(67)</b>	<b>(118)</b>	<b>(50)</b>	<b>(50)</b>	<b>(50)</b>
Div Paid	(32)	(109)	(62)	(70)	(82)
Chg in Gross Debt	(165)	(17)	5	5	5
Capital Issues	15	31	0	0	0
Other Financing CF	0	82	0	0	0
<b>Net Financing CF</b>	<b>(183)</b>	<b>(13)</b>	<b>(57)</b>	<b>(65)</b>	<b>(77)</b>
Currency Adjustments	0	(17)	0	0	0
Chg in Cash	77	66	79	92	118
Opg CFPS (sen)	42.2	48.9	30.9	40.3	45.9
Free CFPS (sen)	42.1	20.9	21.9	25.4	31.4

## Capital Expenditure



Based on 40% dividend payout ratio

Source: Company, DBS Vickers

## Top Glove Corporation

## Quarterly / Interim Income Statement (RM m)

FY Aug	3Q2010	4Q2010	1Q2011	2Q2011	3Q2011
Revenue	556	541	492	485	535
Cost of Goods Sold	(476)	(506)	(450)	(458)	(505)
<b>Gross Profit</b>	<b>80</b>	<b>35</b>	<b>41</b>	<b>28</b>	<b>30</b>
Other Oper. (Exp)/Inc	3	7	3	4	4
<b>Operating Profit</b>	<b>83</b>	<b>42</b>	<b>44</b>	<b>31</b>	<b>34</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>83</b>	<b>42</b>	<b>44</b>	<b>31</b>	<b>35</b>
Tax	(18)	4	(8)	(6)	(8)
Minority Interest	(1)	(1)	0	(1)	0
<b>Net Profit</b>	<b>64</b>	<b>45</b>	<b>36</b>	<b>25</b>	<b>26</b>
Net profit bef Except.	64	45	36	25	26
EBITDA	98	57	60	47	50

## Growth

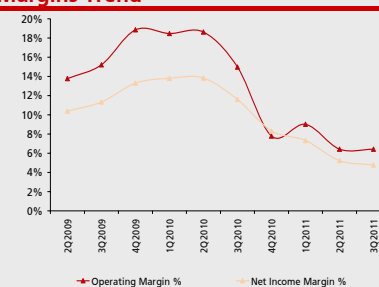
Revenue Gth (%)	9.0	(2.6)	(9.2)	(1.3)	10.3
EBITDA Gth (%)	(10.1)	(41.5)	4.0	(21.4)	5.9
Opg Profit Gth (%)	(12.3)	(49.3)	5.0	(29.6)	10.2
Net Profit Gth (%)	(8.6)	(30.1)	(20.0)	(29.5)	0.8

## Margins

Gross Margins (%)	14.4	6.5	8.4	5.7	5.7
Opg Profit Margins (%)	15.0	7.8	9.0	6.4	6.4
Net Profit Margins (%)	11.6	8.3	7.3	5.2	4.8

Source: Company, DBS Vickers

## Margins Trend



Margins fell due to persistently high NR latex prices and longer time taken to pass on the costs to customers

# Hartalega Holdings Berhad

Bloomberg: HART MK EQUITY | Reuters: HTHB.KL

**BUY RM5.45** KLCI : 1,331.80

Price Target : 12-Month RM 6.50 (Prev RM 6.90)

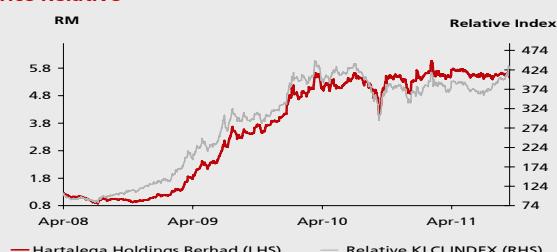
**Potential Catalyst:** Robust healthcare spending, stronger demand for nitrile gloves, and M&A interest

## Analyst

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## Price Relative



## Forecasts and Valuation

FY Mar (RM m)	2011A	2012F	2013F	2014F
Turnover	735	941	1,112	1,328
EBITDA	266	286	313	359
Pre-tax Profit	243	263	282	320
Net Profit	190	202	217	247
Net Pft (Pre Ex.)	190	202	217	247
EPS (sen)	52.3	55.6	59.8	67.9
EPS Pre Ex. (sen)	52.3	55.6	59.8	67.9
EPS Gth (%)	33	6	8	13
EPS Gth Pre Ex (%)	33	6	8	13
Diluted EPS (sen)	52.3	55.6	59.8	67.9
Net DPS (sen)	21.0	21.1	22.7	25.8
BV Per Share (sen)	136.0	170.5	207.6	249.6
PE (X)	10.4	9.8	9.1	8.0
PE Pre Ex. (X)	10.4	9.8	9.1	8.0
P/Cash Flow (X)	10.9	8.0	8.7	7.6
EV/EBITDA (X)	7.2	6.4	5.7	4.7
Net Div Yield (%)	3.9	3.9	4.2	4.7
P/Book Value (X)	4.0	3.2	2.6	2.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	44.8	36.3	31.6	29.7

Earnings Rev (%):	0.0	(3.0)	(5.6)
Consensus EPS (sen):	57.8	65.4	85.5
Other Broker Recs:	B: 10	S: 0	H: 2

ICB Industry : Health Care

ICB Sector: Health Care Equipment & Servic

**Principal Business:** Latex examination gloves, nitrile gloves and technical rubber products manufacturer

Source of all data: Company, DBS Vickers, Bloomberg

## Holding up well

- **Expect demand for nitrile gloves to outpace latex gloves if latex prices stay at current highs**
- **Trimmed FY13-14F EPS by 3-6% after imputing higher nitrile latex and gas costs**
- **Most attractive ROE-PE matrix; Maintain Buy, cut TP to RM6.50**

**Leader in nitrile gloves.** Although nitrile costs have risen to USD2.00/kg, nitrile gloves will still be cheaper than latex gloves if natural rubber (NR) latex prices remain at current highs (last check NR latex was RM8.60/kg). This pricing gap will continue to create strong demand for nitrile gloves. Efforts by glove makers to market nitrile gloves during this period could create sustainable demand. As the leader in nitrile gloves, Hartalega will continue to have strong pricing power despite competition. Its first class products and engineering innovations allow it to reap superior operating margins (28% vs 16% industry average) and ROE (36% vs 22% industry average).

**Trimmed FY13-14F EPS by 3-6%.** This was after accounting for higher nitrile costs (RM5.20/kg vs RM4.70/kg previously) and 20-45% hike in natural gas costs. No change to our FY12F numbers, as the potential 5-6% upside to our earnings (1QFY12 earnings was higher-than-expected) would be sufficient to offset any costs uptick.

**Reiterate Buy; cut TP to RM6.50** (from RM6.90). Our revised target price is pegged to lower 11x CY12 EPS vs 12x previously. This is close to +1 SD, which is justified given Hartalega's superior operating margins and ROE among peers, and most attractive ROE-PE multiple matrix.

## At A Glance

Issued Capital (m shrs)	364
Mkt. Cap (RMm/US\$m)	1,983 / 623
Major Shareholders	
Hartalega Industries (%)	50.6
Budi Tenggara (%)	5.1
Free Float (%)	40.3
Avg. Daily Vol.('000)	241



## Key Assumptions

FY Mar	2010A	2011A	2012F	2013F	2014F
Capacity (bln pcs)	6.5	8.0	9.6	11.2	13.7
Utilisation (%)	80.0	80.0	80.0	80.0	80.0
Nitrile latex (RM/kg)	3.6	3.5	4.7	5.2	5.2
NR Latex price (RM/kg)	6.5	8.2	8.9	8.6	8.2

## Sensitivity Analysis

	2012
Raw material cost +/- 1%	Net Profit +/- 1.8%
Energy cost +/- 1%	Net Profit +/-0.2 %

## Segmental Breakdown

FY Mar	2010A	2011A	2012F	2013F	2014F
<b>Revenues (RM m)</b>					
North America	427	538	699	815	962
South America	15	19	23	29	36
Asia	43	56	73	99	133
Europe	68	95	114	131	151
Others	19	26	32	38	46
<b>Total</b>	<b>572</b>	<b>735</b>	<b>941</b>	<b>1,112</b>	<b>1,328</b>

## Geographical

North America	75%	73%	74%	73%	72%
South America	3%	3%	2%	3%	3%
Asia	8%	8%	8%	9%	10%
Europe	12%	13%	12%	12%	11%
Others	3%	4%	3%	3%	3%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Assumptions for nitrile latex prices raised to RM5.20/kg (from RM4.70/kg), but maintained prices for natural rubber (NR) latex

North America remains Hartalega's key export destinations

Hartalega intends to expand its presence in Asia to capture the vast growth potential in this region

## Income Statement (RM m)

FY Mar	2010A	2011A	2012F	2013F	2014F
Revenue	572	735	941	1,112	1,328
Cost of Goods Sold	(364)	(498)	(685)	(836)	(1,014)
<b>Gross Profit</b>	<b>208</b>	<b>237</b>	<b>256</b>	<b>276</b>	<b>314</b>
Other Opng (Exp)/Inc	(28)	9	9	9	9
<b>Operating Profit</b>	<b>180</b>	<b>246</b>	<b>265</b>	<b>284</b>	<b>322</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(2)	(2)	(2)	(2)	(2)
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>178</b>	<b>243</b>	<b>263</b>	<b>282</b>	<b>320</b>
Tax	(35)	(53)	(60)	(65)	(74)
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>143</b>	<b>190</b>	<b>202</b>	<b>217</b>	<b>247</b>
Net Profit before Except.	143	190	202	217	247
EBITDA	195	266	286	313	359

## Growth

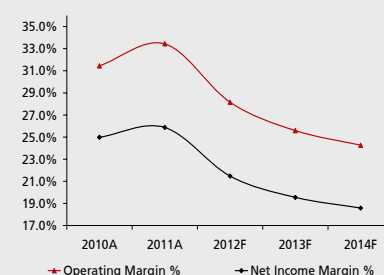
Revenue Gth (%)	29.0	28.5	28.1	18.1	19.4
EBITDA Gth (%)	81.9	35.9	7.6	9.6	14.6
Opg Profit Gth (%)	83.7	36.6	7.8	7.4	13.3
Net Profit Gth (%)	69.1	33.1	6.3	7.6	13.5

## Margins &amp; Ratio

Gross Margins (%)	36.4	32.3	27.2	24.8	23.6
Opg Profit Margin (%)	31.5	33.4	28.2	25.6	24.3
Net Profit Margin (%)	25.0	25.9	21.5	19.6	18.6
ROAE (%)	47.0	44.8	36.3	31.6	29.7
ROA (%)	33.5	34.3	27.9	24.4	23.6
ROCE (%)	38.1	38.7	32.4	29.0	27.7
Div Payout Ratio (%)	33.9	40.1	38.0	38.0	38.0
Net Interest Cover (x)	85.6	99.7	110.8	136.5	181.3

Source: Company, DBS Vickers

## Margins Trend



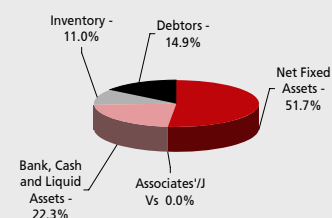
We expect margins to fall due to costs pressure and industry competition as other glove makers are allocating more capacities to nitrile gloves

## Hartalega Holdings Berhad

## Balance Sheet (RM m)

FY Mar	2010A	2011A	2012F	2013F	2014F
Net Fixed Assets	284	349	420	483	518
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	9	0	0	0	0
Cash & ST Invt	75	117	181	221	305
Inventory	28	65	90	109	132
Debtors	83	94	121	143	170
Other Current Assets	0	6	6	6	6
<b>Total Assets</b>	<b>479</b>	<b>631</b>	<b>818</b>	<b>962</b>	<b>1,132</b>
ST Debt	14	15	15	15	15
Other Current Liab	55	61	127	142	163
LT Debt	28	24	19	14	10
Other LT Liabilities	28	37	37	37	37
Shareholder's Equity	354	494	620	754	907
Minority Interests	0	0	0	0	1
<b>Total Cap. &amp; Liab.</b>	<b>479</b>	<b>631</b>	<b>818</b>	<b>962</b>	<b>1,132</b>
Non-Cash Wkg. Capital	56	105	89	116	146
Net Cash/(Debt)	33	78	147	192	280
Debtors Turn (avg days)	47.4	44.0	41.7	43.2	43.0
Creditors Turn (avg days)	42.3	30.0	22.2	23.5	23.6
Inventory Turn (avg days)	27.6	35.6	42.5	44.9	45.1
Asset Turnover (x)	1.3	1.3	1.3	1.2	1.3
Current Ratio (x)	2.7	3.7	2.8	3.1	3.5
Quick Ratio (x)	2.3	2.8	2.1	2.3	2.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	(0.1)	(0.2)	(0.2)	(0.3)	(0.3)
Capex to Debt (%)	162.0	208.7	294.3	345.1	320.3
Z-Score (X)	12.4	12.4	8.7	0.0	NA

## Asset Breakdown



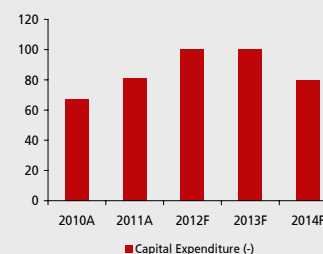
Hartalega has a strong balance sheet and had been in net cash position since FY10. Its strong balance sheet will support future expansion

## Cash Flow Statement (RM m)

FY Mar	2010A	2011A	2012F	2013F	2014F
Pre-Tax Profit	178	243	263	282	320
Dep. & Amort.	20	21	29	37	45
Tax Paid	(22)	(48)	(7)	(60)	(65)
Assoc. & JV Inc/(loss)	0	0	0	0	0
Chg in Wkg.Cap.	(15)	(42)	(38)	(31)	(39)
Other Operating CF	4	8	0	0	0
<b>Net Operating CF</b>	<b>164</b>	<b>182</b>	<b>246</b>	<b>228</b>	<b>262</b>
Capital Exp.(net)	(67)	(81)	(100)	(100)	(80)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	0	0	0	0	0
<b>Net Investing CF</b>	<b>(67)</b>	<b>(81)</b>	<b>(100)</b>	<b>(100)</b>	<b>(80)</b>
Div Paid	(45)	(57)	(77)	(83)	(94)
Chg in Gross Debt	(15)	(2)	(5)	(5)	(4)
Capital Issues	0	0	0	0	0
Other Financing CF	0	0	0	0	0
<b>Net Financing CF</b>	<b>(60)</b>	<b>(59)</b>	<b>(82)</b>	<b>(88)</b>	<b>(98)</b>
Currency Adjustments	(1)	0	0	0	0
Chg in Cash	37	42	64	40	84
Opg CFPS (sen)	49.2	61.7	78.2	71.2	82.6
Free CFPS (sen)	26.6	27.8	40.2	35.1	50.0

Source: Company, DBS Vickers

## Capital Expenditure



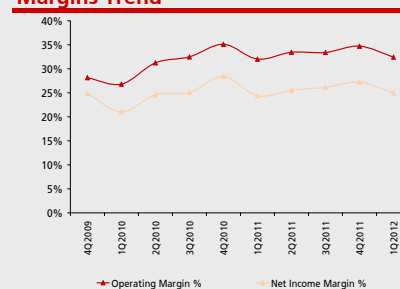
We expect RM170-200m capex for Factory 6 and it will be commissioned progressively over FY13-14

Assume 38% dividend payout ratio

## Quarterly / Interim Income Statement (RM m)

FY Mar	1Q2011	2Q2011	3Q2011	4Q2011	1Q2012
Revenue	170	184	188	193	219
Cost of Goods Sold	(116)	(125)	(127)	(130)	(153)
<b>Gross Profit</b>	<b>54</b>	<b>59</b>	<b>61</b>	<b>63</b>	<b>67</b>
Other Oper. (Exp)/Inc	1	2	2	4	5
<b>Operating Profit</b>	<b>54</b>	<b>62</b>	<b>63</b>	<b>67</b>	<b>71</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(1)	(1)	(1)	(1)	0
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>54</b>	<b>61</b>	<b>62</b>	<b>66</b>	<b>71</b>
Tax	(12)	(14)	(13)	(14)	(16)
Minority Interest	0	0	0	0	0
<b>Net Profit</b>	<b>41</b>	<b>47</b>	<b>49</b>	<b>52</b>	<b>55</b>
Net profit bef Except.	41	47	49	52	55

## Margins Trend



Quarterly performance showed resilience in earnings

## Growth

Revenue Gth (%)	4.0	8.4	2.1	2.3	13.9
Opg Profit Gth (%)	(5.1)	13.3	1.9	6.4	6.5
Net Profit Gth (%)	(10.7)	13.6	4.5	6.5	4.5

## Margins

Gross Margins (%)	31.7	32.3	32.5	32.5	30.3
Opg Profit Margins (%)	32.0	33.4	33.4	34.7	32.4
Net Profit Margins (%)	24.4	25.6	26.2	27.2	25.0

Margin in 1Q2012 fell due to costs pressure but it remains the highest in the industry

Source: Company, DBS Vickers

# Kossan Rubber Industries

Bloomberg: KRI MK | Reuters: KRIB.KL

**HOLD RM2.56 KLCI : 1,331.80**

(Downgrade from Buy)

Price Target : 12-Month RM 2.70 (Prev RM 3.50)

## Analyst

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## Price Relative



## Forecasts and Valuation

FY Dec (RM m)	2010A	2011F	2012F	2013F
Turnover	1,047	1,222	1,311	1,433
EBITDA	183	174	200	228
Pre-tax Profit	141	129	150	175
Net Profit	113	98	114	133
Net Pft (Pre Ex.)	113	98	114	133
EPS (sen)	35.5	30.7	35.8	41.6
EPS Pre Ex. (sen)	35.5	30.7	35.8	41.6
EPS Gth (%)	70	(13)	17	16
EPS Gth Pre Ex (%)	70	(13)	17	16
Diluted EPS (sen)	35.5	30.7	35.8	41.6
Net DPS (sen)	7.7	6.6	7.7	9.0
BV Per Share (sen)	139.9	163.0	192.1	226.1
PE (X)	7.2	8.3	7.2	6.1
PE Pre Ex. (X)	7.2	8.3	7.2	6.1
P/Cash Flow (X)	6.0	9.9	5.5	4.9
EV/EBITDA (X)	4.9	5.0	4.0	3.1
Net Div Yield (%)	3.0	2.6	3.0	3.5
P/Book Value (X)	1.8	1.6	1.3	1.1
Net Debt/Equity (X)	0.2	0.1	CASH	CASH
ROAE (%)	28.2	20.3	20.2	19.9

Earnings Rev (%)	(3.4)	(12.1)	(12.2)
Consensus EPS (sen)	34.4	38.9	42.3
Other Broker Recs:	B: 12	S: 0	H: 4

ICB Industry : Health Care

ICB Sector: Health Care Equipment & Servic

Principal Business: Latex examination gloves, nitrile gloves and technical rubber products manufacturer

Source of all data: Company, DBS Vickers, Bloomberg

## Not spared

- Expanding into higher yield cleanroom products, but impact still small
- Cut FY11-13 EPS by 3-12% on higher nitrile latex and energy costs
- Downgrade to Hold, cut TP to RM2.70

**Diversifying products.** The acquisition of 51% stake in Cleanera HK Limited (at USD3.06m, or RM9.2m based on 3RM/USD) in Jun-11 paves the way for Kossan to venture into higher yielding clean-room gloves. Cleanera manufactures cleanroom products such as masks, wipes and gloves. We expect Cleanera to add 2-3% to Kossan's FY12 net profit, but have not included this yet.

## Nitrile latex prices rising, cut FY11-13F EPS again.

We trimmed FY11-13F net profit by 3-12% after imputing higher nitrile prices (RM5.20/kg vs RM4.70/kg previously) and 20-45% hike in natural gas costs. Our assumptions for natural rubber (NR) latex are unchanged, as we believe prices will hover at above RM8.00/kg despite easing. Following this, operating profit (EBIT) margins should moderate to 11-13% vs 12-14% previously.

**Downgrade to Hold.** We cut target price to RM2.70 (from RM3.50) pegged to 7.5x FY12 EPS, after lowering target multiple from 8.5x to reflect weaker earnings outlook. Our target multiple is equivalent to its 10-year historical mean. Kossan's balanced product mix (40% nitrile, 40% powder free latex, 20% powdered latex gloves) will continue to support margins. Over the last four quarters, EBIT margins only eased 1-3 ppt QoQ (2QFY11: 10.3%) vs Top Glove's 3-7 ppt contraction (3QFY11: 6.4%). That said, Kossan's earnings will not be entirely spared from costs and currency headwinds.

## At A Glance

Issued Capital (m shrs)	320
Mkt. Cap (RMm/US\$m)	819 / 257
Major Shareholders	
Kossan Holdings (%)	51.8
Asian Small Company (%)	4.9
Free Float (%)	43.3
Avg. Daily Vol. ('000)	207

## Key Assumptions

FY Dec	2009A	2010A	2011F	2012F	2013F
Capacity (bil pcs)	9.3	10.3	11.5	13.0	14.6
Utilization Rates (%)	91.4	90.3	90.0	90.0	90.0
NR latex (RM/kg)	4.3	6.5	8.8	8.3	8.1
Nitrile latex (RM/kg)	N/A	4.0	4.7	5.2	5.3

## Sensitivity Analysis

	2012
Raw material cost +/- 1%	Net Profit +/- 4.4%
Energy cost +/- 1%	Net Profit +/- 0.9%

## Segmental Breakdown

FY Dec	2009A	2010A	2011F	2012F	2013F
<b>Revenues (RM m)</b>					
Technical Rubber	87	110	121	133	147
Gloves	755	937	1,101	1,178	1,286
Others	0	0	0	0	0
<b>Total</b>	<b>842</b>	<b>1,047</b>	<b>1,222</b>	<b>1,311</b>	<b>1,433</b>
<b>EBIT (RM m)</b>					
Technical Rubber	7	7	9	10	11
Gloves	89	143	127	147	170
Others	0	(1)	0	0	0
<b>Total</b>	<b>95</b>	<b>149</b>	<b>136</b>	<b>157</b>	<b>181</b>

Assumptions for nitrile latex prices raised to RM5.20/kg (from RM4.70/kg), but maintained prices for natural rubber (NR) latex

## Income Statement (RM m)

FY Dec	2009A	2010A	2011F	2012F	2013F
Revenue	842	1,047	1,222	1,311	1,433
Cost of Goods Sold	(750)	(903)	(1,090)	(1,158)	(1,256)
<b>Gross Profit</b>	<b>93</b>	<b>144</b>	<b>132</b>	<b>153</b>	<b>177</b>
Other Opng (Exp)/Inc	2	4	4	4	4
<b>Operating Profit</b>	<b>95</b>	<b>149</b>	<b>136</b>	<b>157</b>	<b>181</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(9)	(8)	(8)	(7)	(6)
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>86</b>	<b>141</b>	<b>129</b>	<b>150</b>	<b>175</b>
Tax	(18)	(27)	(30)	(35)	(40)
Minority Interest	(1)	0	(1)	(1)	(1)
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>67</b>	<b>113</b>	<b>98</b>	<b>114</b>	<b>133</b>
Net Profit before Except.	67	113	98	114	133
EBITDA	129	183	174	200	228

## Growth

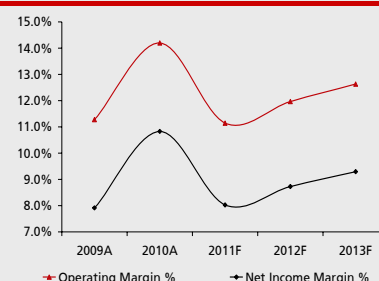
Revenue Gth (%)	(6.1)	24.3	16.7	7.3	9.3
EBITDA Gth (%)	18.0	41.7	(4.6)	14.4	14.3
Opg Profit Gth (%)	13.8	56.5	(8.4)	15.2	15.4
Net Profit Gth (%)	13.7	70.0	(13.4)	16.6	16.4

## Margins &amp; Ratio

Gross Margins (%)	11.0	13.8	10.8	11.6	12.3
Opg Profit Margin (%)	11.3	14.2	11.1	12.0	12.6
Net Profit Margin (%)	7.9	10.8	8.0	8.7	9.3
ROAE (%)	20.3	28.2	20.3	20.2	19.9
ROA (%)	10.0	15.5	11.8	12.2	12.7
ROCE (%)	13.6	20.0	15.6	16.2	16.5
Div Payout Ratio (%)	21.6	21.6	21.6	21.6	21.6
Net Interest Cover (x)	10.4	18.6	18.1	23.0	28.5

Source: Company, DBS Vickers

## Margins Trend



We expect margins to improve over FY12-13F as Kossan moves towards higher yielding products such as nitrile, clean room and surgical gloves

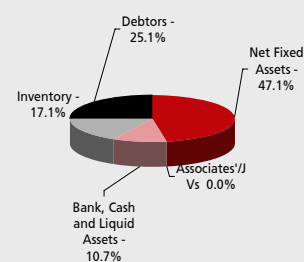
## Industry Focus

### Kossan Rubber Industries

#### Balance Sheet (RM m)

FY Dec	2009A	2010A	2011F	2012F	2013F
Net Fixed Assets	359	409	411	413	411
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	2	1	1	1	1
Cash & ST Invt	17	90	93	164	260
Inventory	110	125	149	158	171
Debtors	140	144	219	235	257
Other Current Assets	55	13	13	13	13
<b>Total Assets</b>	<b>684</b>	<b>783</b>	<b>887</b>	<b>985</b>	<b>1,114</b>
ST Debt	132	133	133	133	133
Other Current Liab	124	139	183	197	216
LT Debt	46	26	11	1	1
Other LT Liabilities	23	36	36	36	36
Shareholder's Equity	357	447	521	614	723
Minority Interests	1	2	3	4	5
<b>Total Cap. &amp; Liab.</b>	<b>684</b>	<b>783</b>	<b>887</b>	<b>985</b>	<b>1,114</b>
Non-Cash Wkg. Capital	181	144	199	210	226
Net Cash/(Debt)	(161)	(69)	(51)	30	126
Debtors Turn (avg days)	65.3	49.6	54.3	63.3	62.7
Creditors Turn (avg days)	59.1	51.3	48.6	51.5	51.0
Inventory Turn (avg days)	56.7	49.5	47.6	50.2	49.7
Asset Turnover (x)	1.3	1.4	1.5	1.4	1.4
Current Ratio (x)	1.3	1.4	1.5	1.7	2.0
Quick Ratio (x)	0.6	0.9	1.0	1.2	1.5
Net Debt/Equity (X)	0.4	0.2	0.1	CASH	CASH
Net Debt/Equity ex MI (X)	0.5	0.2	0.1	0.0	(0.2)
Capex to Debt (%)	18.0	52.7	27.7	33.5	33.5
Z-Score (X)	3.9	4.5	4.3	4.4	4.4

#### Asset Breakdown

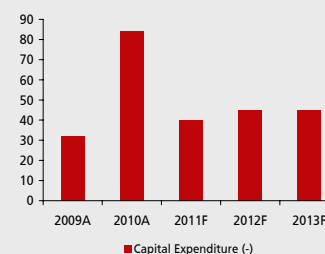


Balance sheet remains strong. Low net gearing in FY11F and expect to turn to net cash position by FY12F

#### Cash Flow Statement (RM m)

FY Dec	2009A	2010A	2011F	2012F	2013F
Pre-Tax Profit	86	141	129	150	175
Dep. & Amort.	34	34	38	43	47
Tax Paid	0	0	(11)	(30)	(35)
Assoc. & JV Inc/(loss)	0	0	0	0	0
Chg in Wkg.Cap.	(67)	(14)	(73)	(16)	(21)
Other Operating CF	2	(25)	0	0	0
<b>Net Operating CF</b>	<b>54</b>	<b>135</b>	<b>83</b>	<b>148</b>	<b>166</b>
Capital Exp.(net)	(32)	(84)	(40)	(45)	(45)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	0	0	0	0	0
<b>Net Investing CF</b>	<b>(32)</b>	<b>(84)</b>	<b>(40)</b>	<b>(45)</b>	<b>(45)</b>
Div Paid	(8)	(14)	(24)	(21)	(25)
Chg in Gross Debt	(9)	(15)	(15)	(10)	0
Capital Issues	0	0	0	0	0
Other Financing CF	0	43	0	0	0
<b>Net Financing CF</b>	<b>(18)</b>	<b>14</b>	<b>(39)</b>	<b>(31)</b>	<b>(25)</b>
Currency Adjustments	0	8	0	0	0
Chg in Cash	5	73	3	71	96
Opg CFPS (sen)	38.0	46.8	48.7	51.0	58.6
Free CFPS (sen)	7.0	16.1	13.3	32.1	37.8

#### Capital Expenditure



Assume 22% dividend payout ratio

Source: Company, DBS Vickers

## Quarterly / Interim Income Statement (RM m)

FY Dec	2Q2010	3Q2010	4Q2010	1Q2011	2Q2011
Revenue	256	276	253	256	276
Cost of Goods Sold	(219)	(236)	(220)	(227)	(248)
<b>Gross Profit</b>	<b>38</b>	<b>40</b>	<b>33</b>	<b>29</b>	<b>27</b>
Other Oper. (Exp)/Inc	1	1	3	1	1
<b>Operating Profit</b>	<b>38</b>	<b>40</b>	<b>37</b>	<b>30</b>	<b>29</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(2)	(2)	(2)	(2)	(2)
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>36</b>	<b>38</b>	<b>35</b>	<b>28</b>	<b>27</b>
Tax	(6)	(10)	(5)	(5)	(5)
Minority Interest	0	0	0	0	0
<b>Net Profit</b>	<b>30</b>	<b>29</b>	<b>29</b>	<b>23</b>	<b>21</b>
Net profit bef Except.	30	29	29	23	21
EBITDA	38	40	37	30	29

## Growth

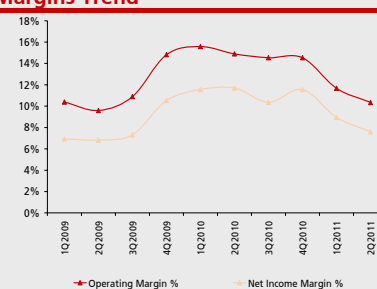
Revenue Gth (%)	(2.4)	7.5	(8.2)	1.4	7.5
EBITDA Gth (%)	(22.9)	4.8	(8.3)	(18.5)	(4.8)
Opg Profit Gth (%)	(6.7)	4.8	(8.3)	(18.5)	(4.8)
Net Profit Gth (%)	(1.2)	(4.8)	2.4	(21.5)	(8.8)

## Margins

Gross Margins (%)	14.6	14.3	13.2	11.4	9.8
Opg Profit Margins (%)	14.9	14.5	14.5	11.7	10.3
Net Profit Margins (%)	11.7	10.4	11.6	9.0	7.6

Source: Company, DBS Vickers

## Margins Trend



Margin fell due to rising raw material prices and time lag in passing on the higher costs to customers

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*Share price appreciation + dividends*

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