CIMB

SECTOR UPDATE

5 April 2011

CIMB Research Report

MALAYSIA

Rubber Gloves

OVERWEIGHT | Maintained

Rubber hits the road

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- **Maintain OVERWEIGHT.** Taking our cue from higher latex prices, we raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. This reduces our FY11-12 sector net profit by 8-9%. Despite the earnings cut and the disappointing results season, we continue to rate the sector an OVERWEIGHT as the headwinds have left the sector's CY12 P/E at 8.5x or c.30% below the KLCI's 12.7x P/E. This is despite a 3-year EPS CAGR of 11%, which is supported by 8-15% annual demand growth. Kossan replaces Hartalega as our top pick given Hartalega's margin compression and better upside for Kossan. Potential re-rating catalysts for the sector include 1) higher outsourcing and 2) lower input costs.
- **Results roundup.** Annualised net profit for the companies under coverage missed expectations, coming in at just 78% of our estimates and 82% of consensus. Results were weighed down by a 64% yoy slump in Top Glove's 2QFY8/11 net profit due to higher input cost and weak demand. Sector revenue for the quarter fell 2% qoq because of higher sales of nitrile gloves which have lower selling prices. On yoy basis, revenue rose 16% due to capacity expansion. But rising costs pulled the sector net profit down 24% qoq and 220% yoy.
- **Rubber prices fall and bounce back…** After peaking at RM10.89/kg on 22 Feb, rubber latex price fell 21% in two weeks to RM8.56/kg on the back of growth concerns. The fall was accentuated by disruptions to global supply chains after Japan's earthquake. But rubber's price fall was short-lived as prices bounced back with a vengeance, rising 24% in just over a week to RM10.65/kg as at 4 April.
- **…nitrile also heads north.** Nitrile latex producers raised prices around the same time (by c.10% in March) as midstream refiners battled with a Brent price of above US$100/bbl. Even so, the volatility of rubber has renewed interest in glove stocks, which have been out of favour lately.
- **Balanced product mix mitigates cost volatility.** Glovemakers can mitigate the cost volatility by diversifying their product mix. While customers in regulated markets such as the US and EU are unlikely to change buying behaviour, emerging market end-users are more fickle. Glovemakers with a balanced product mix such as Kossan (40:60 nitrile:rubber mix) are best positioned to meet demand from growth markets in emerging Asia and Latin America.
- **We like Kossan and Hartalega.** Kossan is the most balanced glovemaker, has consistently met expectations and offers more upside than Hartalega. Despite offering 21% EPS growth for FY12, the stock trades at only 6.5x forward P/E. While it is true that Hartalega will continue to benefit from the switch to synthetics, we expect its margin to contract in FY12 as refiners start raising prices.

Sector comparisons

	Bloomberg ticker	Recom.	Price (Local)	Target price (Local)	Mkt cap (US$ m)	Core P/E (x) CY2011	Core P/E (x) CY2012	3-yr EPS CAGR (%)	P/BV (x) CY2011	ROE (%) CY2011	Div yield (%) CY2011
Adventa	ADV MK	O	2.35	2.98	119	12.2	8.0	7.3	1.3	11.3	3.3
Hartalega	HART MK	O	5.50	8.25	661	10.1	8.7	18.0	3.3	37.5	3.6
Kossan	KRI MK	O	3.28	5.14	347	7.8	6.5	14.6	1.8	25.7	3.0
Latexx	LTX MK	N	2.78	3.10	204	7.5	6.7	15.0	2.0	30.0	4.0
Supermax	SUCB MK	O	4.23	5.84	475	8.9	8.4	4.7	1.7	20.0	2.6
Top Glove	TOPG MK	N	5.32	5.98	1,087	18.0	12.9	7.6	2.7	15.6	4.2
Simple average						**10.8**	**8.5**	**11.2**	**2.1**	**23.4**	**3.5**

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

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Results roundup

Results missed the mark. Overall, the combined annualised net profit of the glovemakers we cover missed expectations, coming in at 78% of our estimates and 82% of consensus (Figure 1). Results were weighed down by a 64% yoy slump in Top Glove's 2QFY8/11 net profit due to higher input cost and weak demand. Overall, sector revenue fell 1.6% qoq because of higher sales of nitrile gloves which have lower selling prices. On yoy basis, sector revenue rose 15.6% due to capacity expansion and strong demand for surgical gloves. However rising input costs pulled the sector's net profit down 23.9% qoq and 22.0% yoy.

Figure 1: Results round-up for the glove sector

	Lastest	Date of	Financial performance		Versus expectations		Above / Below	
Company	**Quarter**	**Last Ann**	**EBIT**	**Net profit**	**CIMB**	**Consensus**	**CIMB**	**Consensus**
Adventa	01/11 Q1	3/31/2011	5.0	4.1	44.0%	42.0%	Below	Below
Hartalega	12/11 Q3	2/7/2011	62.8	49.2	99.4%	102.6%	In line	In line
Kossan	12/10 Q4	2/23/2011	36.8	29.2	96.1%	101.8%	In line	In line
Latexx	12/10 Q4	2/21/2011	18.8	10.5	86.6%	87.9%	Below	Below
Supermax	12/10 Q4	2/14/2011	22.3	32.7	91.0%	95.0%	Below	In line
Top Glove	02/11 Q2	3/16/2011	31.2	25.4	49.0%	63.0%	Below	Below
Average			**29.5**	**25.2**	**77.7%**	**82.1%**	**Below**	**Below**

	Lastest	Date of	Revenue % change		EBIT % change		Net profit % change	
Company	**Quarter**	**Last Ann**	**qoq**	**yoq**	**qoq**	**yoq**	**qoq**	**yoq**
Adventa	01/11 Q1	3/31/2011	16.7%	38.6%	-15.3%	-55.7%	-65.7%	-56.7%
Hartalega	12/11 Q3	2/7/2011	2.1%	26.6%	1.9%	30.2%	4.5%	32.3%
Kossan	12/10 Q4	2/23/2011	-8.2%	11.1%	-8.3%	8.9%	2.4%	22.0%
Latexx	12/10 Q4	2/21/2011	-17.8%	3.8%	-13.3%	-0.3%	-40.7%	-39.5%
Supermax	12/10 Q4	2/14/2011	-1.0%	18.5%	-39.4%	-51.1%	-14.2%	-25.8%
Top Glove	02/11 Q2	3/16/2011	-1.3%	-4.8%	-29.6%	-67.1%	-29.5%	-64.0%
Average			**-1.6%**	**15.6%**	**-17.3%**	**-22.5%**	**-23.9%**	**-22.0%**

Source: Company, CIMB Research, Bloomberg, Bursa Malaysia

The synthetic switch. During the quarter, all companies emphasised nitrile. We sense that there is a substantial structural shift away from rubber to synthetics. New demand is being synthesised quickly as distributors and hospitals strive to lower costs. This switch is in line with our assumption that nitrile glove demand will notch up a 5-year CAGR of 15%, higher than the 8% 5-year CAGR for natural rubber.

- **Hartalega** – We were positively surprised by Hartalega's indication that nitrile comprised 90% of total capacity, which is higher than our 83% estimate. The company attributed the higher nitrile contribution to better-than-expected demand from emerging markets such as Brazil and China.
- **Kossan** – Nitrile now constitutes c.40% of Kossan's total revenue, up from c.30% in 3Q10. According to management, nitrile's lower cost has enabled the company to hold EBITDA margins steady at 18% despite an 8% qoq decline in sales. We expect the company to raise nitrile production to 50% in the upcoming quarters.
- **Latexx** – Nitrile sales comprised 50% of group sales in 4Q, up from 43% in 3Q. The company is looking to increase nitrile to 65% by end-FY11 to meet higher demand.
- **Supermax** raised nitrile from 24% of total capacity to 30% during the quarter. The company said that it has the ability to increase nitrile production quickly to 40-45% of total capacity should demand be strong.
- **Top Glove's** nitrile contribution rose from 7% to 10-11%. The company aims to reach 15% by end FY11 and indicated that 70% of its facilities have the potential to switch from natural rubber to nitrile.

Industry updates

Glovemakers seek upstream expansion. Glovemakers are keen to acquire rubber plantations to secure raw material supply. Top Glove was the first to state its intention and Kossan followed suit. Both companies are targeting Cambodia where land is affordable and the weather conducive.

- **Top Glove** – In Jan 2011, management signed an MOU and will formalise an agreement to acquire 10k ha of greenfield land (99 yrs) by June-July 2011. The EPS impact will be negligible given rubber's six-year gestation period. Management expects first planting by 1H12 and its first tapping by 1H18. The total cost for the project is c.RM30m, implying a unit cost of RM3,000 per ha. We view this as fair as raw plantation land in Indonesia costs c.US$1,000 per ha. Based on current yields, the company expects latex from the 10k ha to supply 15% of its requirements.

- **Kossan** – Management said that it may acquire plantations in Cambodia and/or Indonesia. While no budget has been finalised, we expect management to fund this acquisition with internally generated funds. As at 31 Dec 2010, Kossan had RM89.9m cash and RM69.2m net debt.

PE firms show interest in gloves. Since Jan, several private equity firms have made bids for glovemakers. While this indicates renewed interest in the sector and would set a valuation floor, valuations must be scrutinised.

- Latexx Partners – On 29 Jan, Latexx accepted a non-binding bid by Navis Capital and Mettiz Capital Ltd to acquire its entire business for RM852.03m or RM3.10 per share. Navis has exclusivity up to 15 May to finalise definitive terms. At the time of the offer, Navis's bid was 18% above Latexx's 1-mth volume-weighted average price (VWAP) of RM2.63 but only 11% higher than the last price of RM2.80 and 20% lower than our target price of RM3.85. We are disappointed by the low offer and view it unfavourably. If a binding bid of RM3.10 is tabled, we recommend rejecting it.
- YTY Group – On 11 Mar, Reuters reported that Carlyle and Affinity were through to the second round of bidding for unlisted glovemaker YTY. The deal is expected to be completed by mid-April 2011. Nomura and CIMB are the advisers. The PE firms are valuing YTY at 10x FY10 P/E and the deal size is estimated at US$330m or c.RM1bn. YTY produces powder-free latex and nitrile gloves. According to YTY's website, it will increase capacity from 8.2bn to 10.5bn pieces of gloves by 2012.

Big boys stay organic. Large glovemakers are unlikely to expand through acquisitions. While some approached smaller glove companies in 2010, valuation expectations at the time were too high. Also, we believe that recent interest from PE firms such as Navis, Carlyle, and Affinity will inflate valuations. For example, Top Glove has indicated that at the valuations that some small glovemakers are seeking, the company prefers to expand organically even if it takes more time.

MITI gives thumbs-up to Hartalega. On 25 Feb, officials from the Ministry of International Trade and Industry, Department of Environment (DOE), and Kuala Selangor local council visited Hartalega to obtain updates in order to understand environmental allegations levelled at it. After the visit, MITI gave assurances that Hartalega had not violated any environmental standards and was compliant.

Major bird flu news. An outbreak would be positive for demand. Utilisation rates are now 70-90% and will rise in line with delivery backlogs. Currently, there is a backlog of 1-3 months but it could rise to five months, as it did during 2009's H1N1 pandemic.

- January 2011
  - 3 Jan: S. Korea confirmed its first outbreak of bird flu in two years and culled c.100,000 birds after a Korean man died from swine flu (AFP).
  - 17 Jan: British scientists developed genetically modified chickens that cannot transmit bird flu infections. This could reduce the spread of avian flu (Reuters).
  - 28 Jan: The Aichi prefecture in Japan culled c.150,000 chickens after confirming the chickens had contracted the H5 strain of bird flu (AP).
- February 2011
  - 2 Feb: The Miyazaki prefecture in Japan culled c. 40,000 chickens after confirmation of the sixth outbreak of the bird flu virus (Japan Today).
  - 7 Feb: Bird flu attacked Indonesia's Jambi province, triggering the culling of c. 4,000 chickens in Kerinci regency (Xinhua).
  - 9 Feb: c.20,000 chickens died in Kabupaten Pontianak, West Kalimantan. Samples of dead chicken showed positive bird flu H5N1 (Kompas).
  - 9 Feb: Two men died in Hong Kong after contracting swine flu. Hong Kong officials say 35 people were being treated for swine flu (AFP).
  - 10 Feb: A five-year-old Cambodian girl died from bird flu (AsiaOne).
  - 10 Feb: Bangladesh culled c.50,000 chickens following a fresh outbreak of the

bird flu virus (Xinhua).

- March 2011
  - 7 Mar: The Miyazaki prefecture in Japan culled c.33,000 chickens after bird flu is confirmed. 990,000 chickens have been culled since 22 Jan (Japan Today).
  - 10 Mar: c.40,000 turkeys were set to be slaughtered at Kibbutz Rosh Tsurim in Gush Etzion after the deadly bird flu virus was discovered (Jerusalem Post).
  - 14 Mar: The Chiba prefectural government culled 35,000 birds and restricted the movements of another 869,000 birds being raised near the farm (Japan Today).
  - 25 Mar: Dutch authorities culled 127,500 egg-laying hens on a farm in Southern Netherlands after the H7 bird flu strain was detected (World Poultry).
  - 4 Apr: Thousands of chickens die on Indonesia's Sumatra Island due to bird flu (Bernama)

Glovemaking now more cyclical… For most of their trading history, glovemakers' stock betas have been in line or below the market, i.e. FBM KLCI. We attribute this past defensive quality to stable demand and material costs. The landscape, however, has changed. Average stock betas have increased in each of the past two years, from 0.87 to 1.27 (Figure 2). In our view, the greater share price volatility is due to higher input prices and lower cost pass-through. The difficulty the sector faces in hedging material costs has amplified the impact of external shocks such as natural disasters, non-seasonal weather patterns and civil unrest in oil-producing countries.

Figure 2: Evolution of glovemakers' stock betas

Beta vs FBMKLCI	'09-'11	'07-'09	'05-'07	'03-'05	'01-'03	'99-'01	'97-'99	'95-'97
Adventa	1.48	0.93	0.76	0.93	-	-	-	-
Hartalega	0.95	0.78	-	-	-	-	-	-
Kossan	0.94	1.01	0.87	1.04	1.05	0.80	1.04	0.85
Latexx	1.66	1.70	1.40	1.49	1.57	1.20	1.02	1.16
Supermax	1.65	0.70	0.71	1.10	1.07	0.70	-	-
Top Glove	0.96	0.79	0.59	0.79	0.76	-	-	-
Average	**1.27**	**0.99**	**0.87**	**1.07**	**1.11**	**0.90**	**1.03**	**1.00**

Source: Company, CIMB Research, Bloomberg

…leading to greater caution. We sense from recent visits greater caution among management. Most of them refrained from revealing internal earnings KPIs for fear of drastic revisions in the near future. One glovemaker not under our coverage said that the internal KPIs set a few months ago are under review after the sharp increase in nitrile prices. Another top glovemaker said that it would be more comfortable providing earnings guidance in August when it is much closer to its financial year-end in December.

Product diversification can mitigate volatility… One way glovemakers mitigate volatile costs is by diversifying their product mix. While customers in regulated markets such as the US and EU are unlikely to change buying behaviour, emerging market end-users are more fickle. We saw this in 1Q11 when all the glovemakers increased nitrile production to meet demand. Overall, glovemakers with a balanced product mix such as Kossan (40:60 nitrile/rubber mix) are best-positioned to meet demand from growth markets in emerging Asia and Latin America.

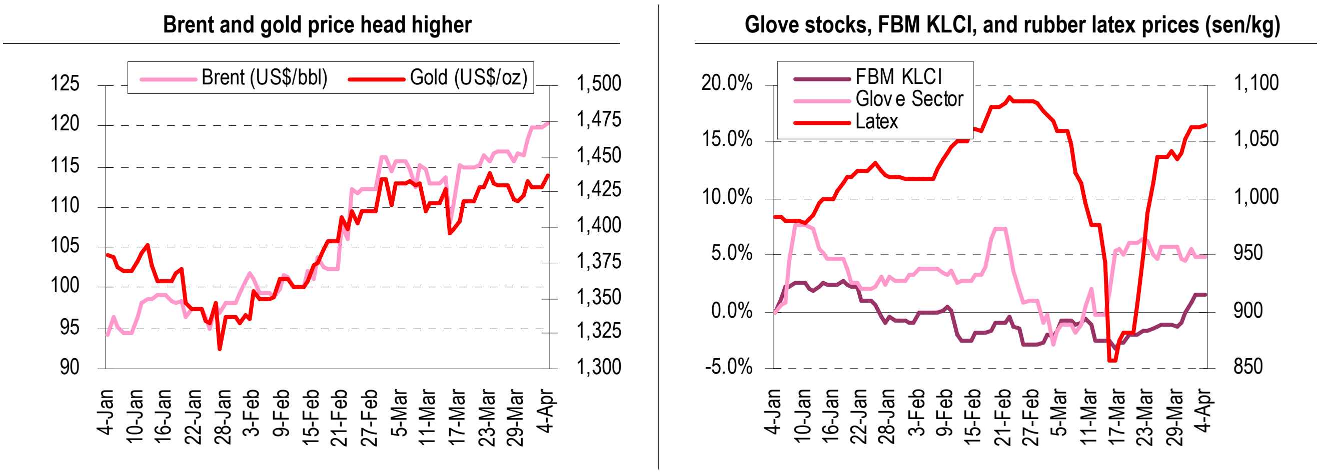
…unless you're niche or specialised. Flexibility matters less to niche glovemakers such as Hartalega or Adventa. Hartalega is focused on synthetics and has very little interest in rubber. Adventa specialises in surgical gloves for which nitrile is not suitable as it cannot match the fine control and greater sensitivity-to-touch of rubber.

Share price performance

Glove stocks start year with a bang and… Glove stocks started the year well, rising 8% in the first week of trading. Notably, Supermax rose 17% in the second week of 2011 as management went on the road. Hartalega also saw a 14% rise in its market value after its non-deal roadshow in Thailand.

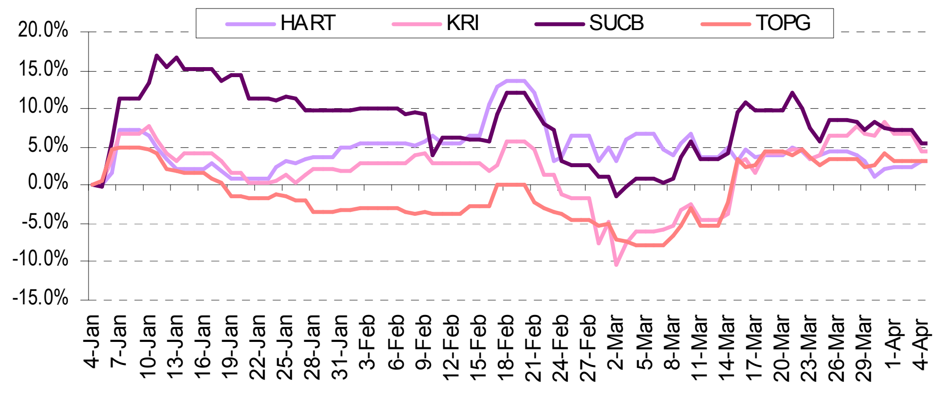
…seesawed in Feb-Mar. Returns moderated as rubber prices escalated. As at 4 April, glove stocks had outperformed the FBM KLCI, returning +5% YTD versus a 1% gain for the KLCI. Glovemakers fell at the end of Feb due to inflation and growth concerns but rebounded in mid-Mar after rubber prices collapsed. Latexx was the sector's top performer (+10%), supported by Navis's non-binding bid.

Figure 3: Performance of the glove stocks under our coverage



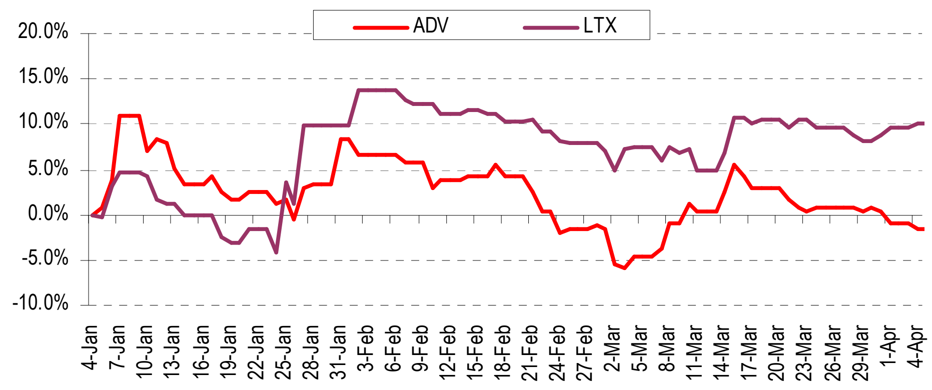
Source: Company, CIMB Research, Bloomberg

Figure 4: Relative performance of Big 4 glovemakers



Source: Company, CIMB Research, Bloomberg

Figure 5: Relative performance of small-cap glovemakers



Source: Company, CIMB Research, Bloomberg

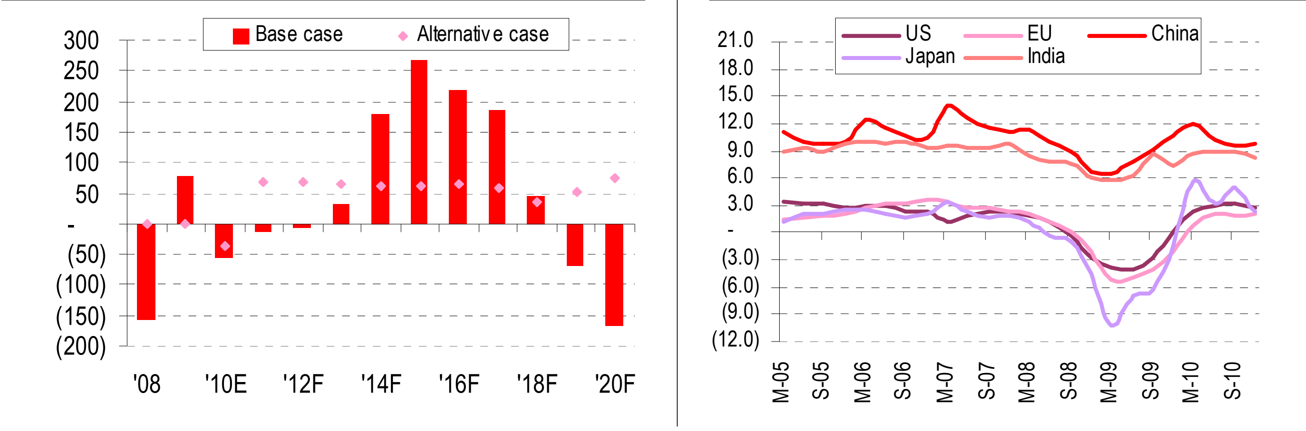
Rubber supply and demand

Near-term tightness will keep rubber prices volatile. From a surplus of c.230k t in 2009, we expect natural rubber supply-demand to move to a 35-56k t deficit in 2010 as demand recovers. Over the next few years, rubber's deficit should narrow as trees planted during the 2005-08 period reach yielding age. Even so, we expect the supply situation to remain tight, keeping prices volatile and newsflow-driven.

Figure 6: World natural rubber supply and demand

World natural rubber surplus / (deficit) ('000 t)

Major economies returned to growth in 2010 (% yoy growth)



Source: Company, CIMB Research, International Rubber Study Group, LMC International, Sri Trang Agro-Industry Public Company Limited, Bloomberg

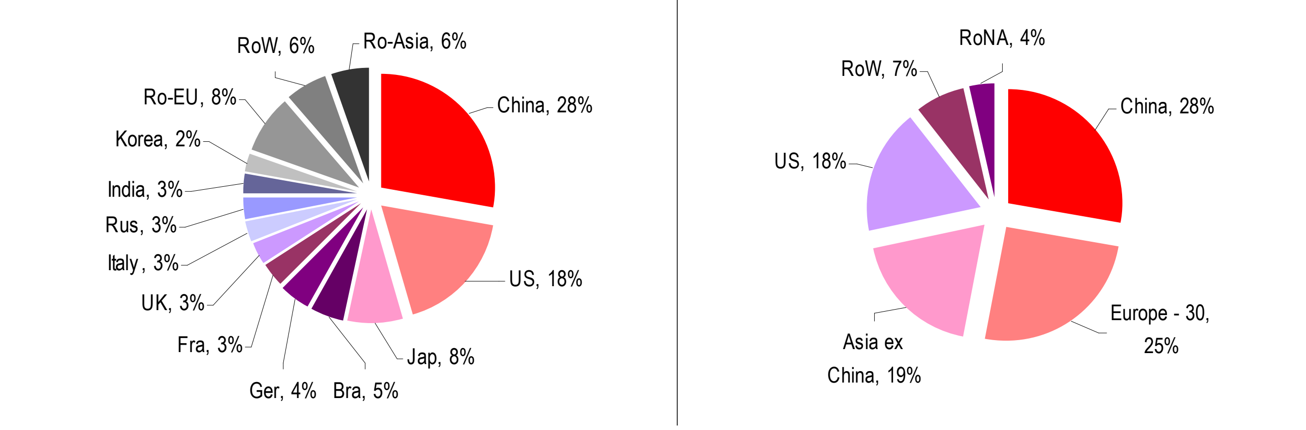
Processors indicate robust demand. Our sense from visits to top rubber processors is that rubber demand remains strong. Despite the crash in rubber prices in mid-March, midstream players are optimistic about demand. Their view has been validated by the recovery of rubber prices, which have risen c.24% (4 April: RM10.65/kg) in just over a week after plunging c.33% from mid Feb to mid March.

Tyre consumption key to demand. Demand is dominated by the auto industry as tyres make up c.70% of demand. The 30% balance is from shoes, hoses, belts, non-tyre automotive components and gloves. China is the biggest automotive market with 18m new vehicles sold in 2010 or 28% of global vehicle sales. The other major auto markets are the US, Japan, and Brazil (Figure 7).

Figure 7: Tyre consumption accounts for 70% of rubber demand

2010 new vehicle sales by country (% total)

2010 new vehicle sales by key geography (% total)

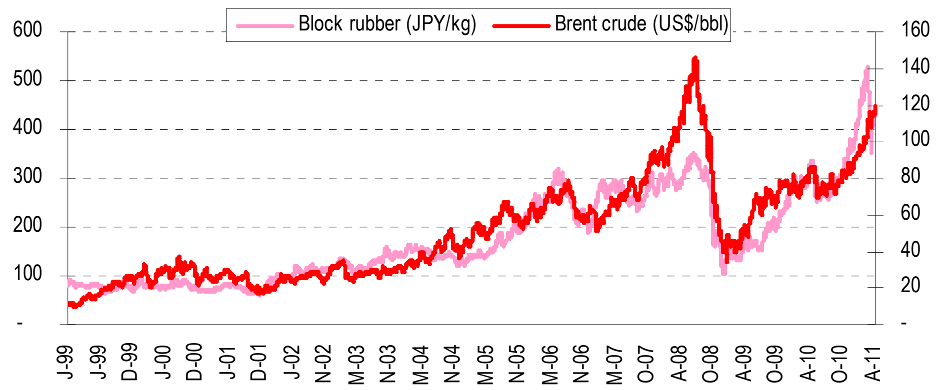


Source: Company, CIMB Research, Bloomberg Industries

Synthetic rubber substitution... Rubber content in tyres depends on design, country and use. For example, tyres used by heavy commercial vehicles require higher natural rubber content while tyres used for light passenger cars (e.g. taxis) can use more synthetic rubber. Rubber content also varies by country due to differences in regulation and levels of urbanisation. In India, most tyre manufacturers use a minimum of c.70% natural rubber while in the US, the minimum is closer to 45%.

…has its limits. Use of synthetic rubber in tyres is limited due to the durability and elasticity properties of rubber. As a result, lowering the rubber content by too much changes tyre performance. Typically, the scope for substitution between natural and synthetic rubber in tyre manufacturing is less than 10%. As a result, tyre manufacturers are more likely to raise natural rubber content when petroleum prices are high, keeping rubber demand robust and prices positively correlated with oil (Figure 8).

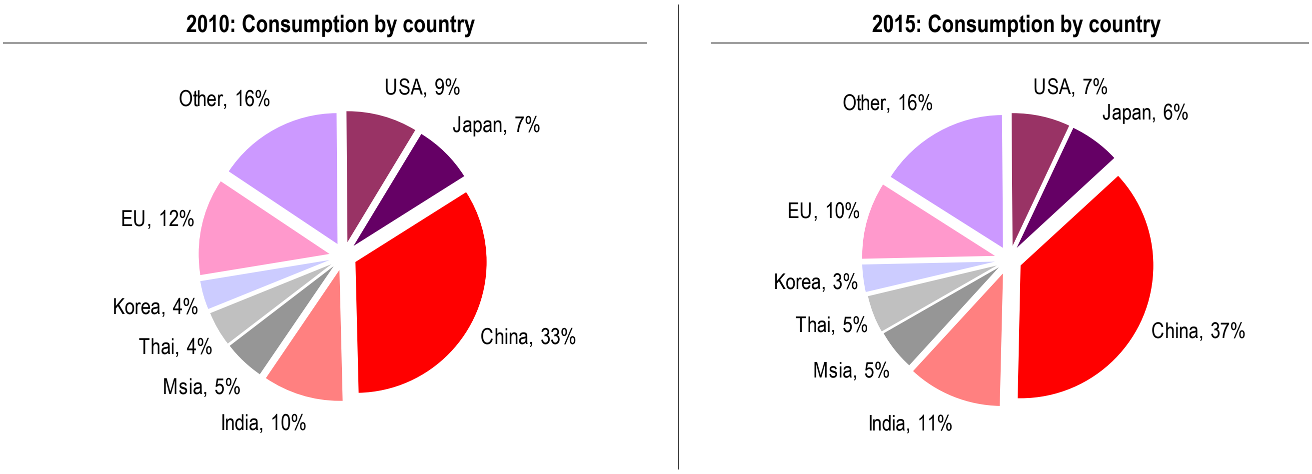
Figure 8: Limited use of synthetic rubber in tyre-making means rubber and oil track each other



Source: Company, CIMB Research, Bloomberg

Asia's clout to increase over next five years. We expect Asia to command a greater share of world rubber demand. Already, China accounts for a third of demand and is expected to increase to c.37% by 2015. At the same time, developed economies such as the US, EU, and Japan will see their contribution to demand shrink as tyre manufacturing migrates to lower-cost countries.

Figure 9: Changes in natural rubber demand patterns over next 5 years



Source: Company, CIMB Research, Bloomberg Industries

Tough economics limits visibility on returns. New plantings take 6-7 years to reach yielding age, thereby limiting visibility on investment returns. While there is ongoing R&D to shorten the gestation period and raise crop yields, these projects are a work in progress and will take time to materialise. Also, rubber is a labour-intensive activity that requires daily tapping to yield maximum returns.

Oil palm preferred by governments. As a result, oil palm has become a more attractive crop in Malaysia and Indonesia. For one, oil palms reach yielding age in four years and are harvested a few times a week. Also, being a food and energy source, oil palm is subsidised by governments in Malaysia and Indonesia.

High prices renew risk appetite… Despite the agronomic challenges, rubber's price rise has made the crop economically viable once again. At current prices, plantation companies indicate that rubber is multiple times more profitable than oil palm. This has prompted First Resources Limited (FR SP; Not Rated) to set aside 40k ha of its new 100k ha estate in East Kalimantan for rubber.

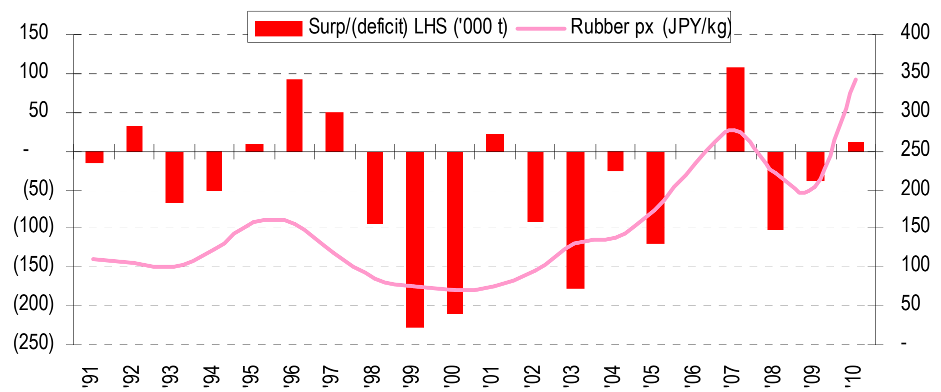
…among the downstream folks too. Even the downstream sector has jumped on the bandwagon, with glovemakers Top Glove (TOPG MK; Neutral) and Kossan (KRI MK; Outperform) indicating that they are exploring land acquisitions in Cambodia and Indonesia for rubber. Top Glove is finalising the purchase of a 10k ha piece of land that would provide 15% of its current latex requirements.

Corporate interest reignited. There has also been renewed corporate activity among rubber companies such as GMG Global Ltd (GGL SP; Not Rated) and Sri Trang Agro-Industry Public Company Ltd (STA TB; Not Rated). In Nov 2010, GMG acquired a 55% interest in non-listed Thai rubber processor Tek Bee Hang while Sri Trang listed 20% of its shares in Singapore in Jan 2011.

Rubber correlations

Positive relationship between price and supply/demand… As expected, rubber price is inversely correlated with supply/demand surpluses and deficits. This is seen clearly in Figure 10 below where long periods of rubber deficits and tight supply in 1998-2006 led to rising prices. In 2007 when there was a 106k t surplus of rubber, prices slumped for the next two years before scaling new highs on the back of a two-year deficit in 2008-09.

Figure 10: Rubber surplus/(deficit) vs. rubber price

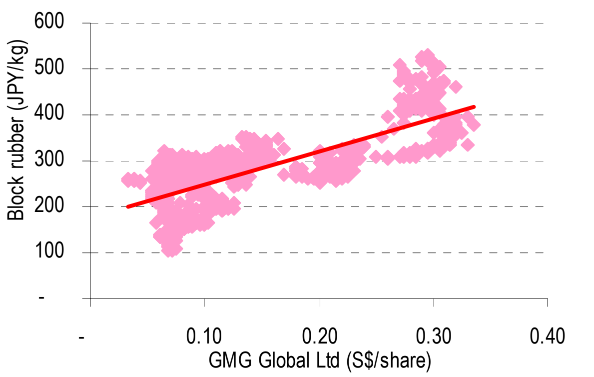


Source: Company, CIMB Research, Bloomberg

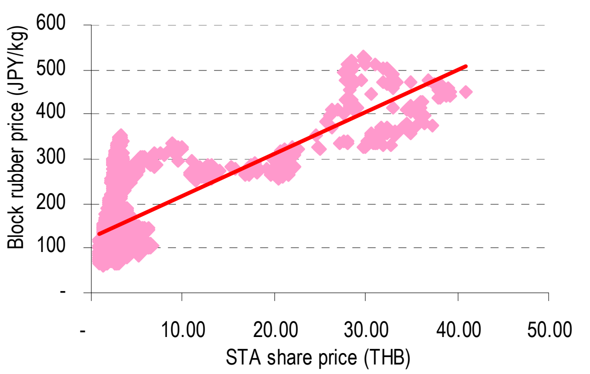
Upstream and midstream profit from rubber price uptrend… Our analysis suggests that the share prices of rubber planters and processors perform best in a rising rubber market. This to be expected. For planters, costs are fixed while commodity prices fluctuate on a daily basis. For rubber processors, a rubber uptrend enables them to buy raw materials at lower prices and on-sell products at a higher price.

Figure 11: Correlation between rubber price and the upstream / midstream rubber sector

Upstream – GMG Global Ltd



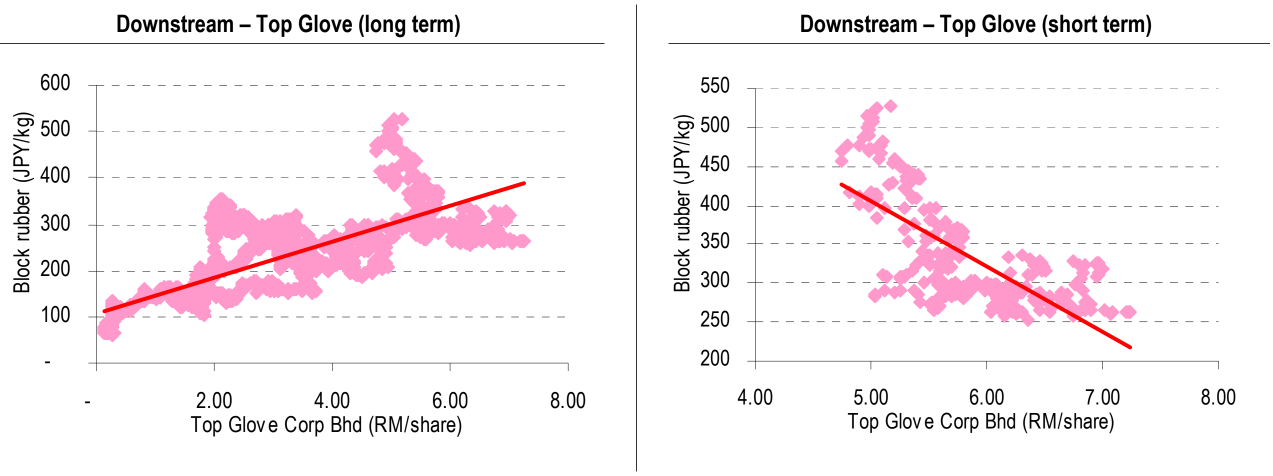
Midstream – Sri Trang Agro-Industry



Source: Company, CIMB Research, Bloomberg

…but not so for downstream sector. While long-term data show a positive correlation between glovemakers' share prices and rubber prices, the trend has reversed over the past 12 months. We believe this is due to the normalisation of demand post H1N1, higher capacity in recent years and difficulty in passing on costs at these high rubber prices.

Figure 12: Correlation between rubber price and the downstream rubber sector

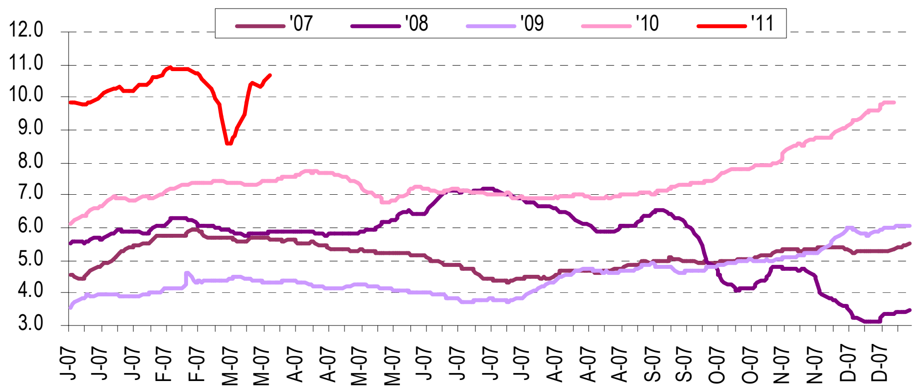


Source: Company, CIMB Research, Bloomberg

Rubber price trends

Rubber corrects after peaking in Feb. After peaking at RM10.89/kg on 22 Feb, rubber latex price fell 21% in two weeks to RM8.56/kg on the back of growth concerns. The fall was accentuated by disruptions to global supply chains after Japan's earthquake. Rubber price's fall was short-lived as prices bounced back with a vengeance, rising 20% in just over a week to RM10.65/kg as at 4 April.

Figure 13: Rubber latex spot price cycle in 2007-2011 (RM/kg)



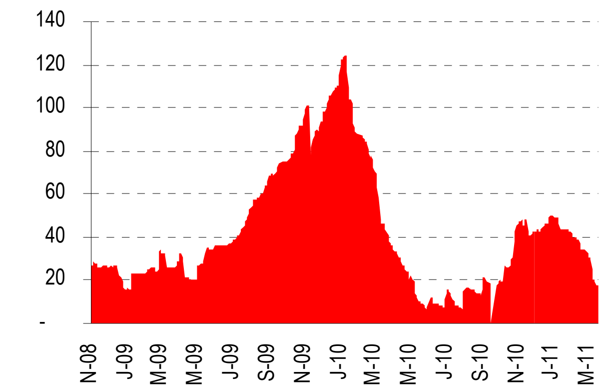
Source: Company, CIMB Research, Bloomberg, Malaysian Rubber Board

Key counter-growth events:

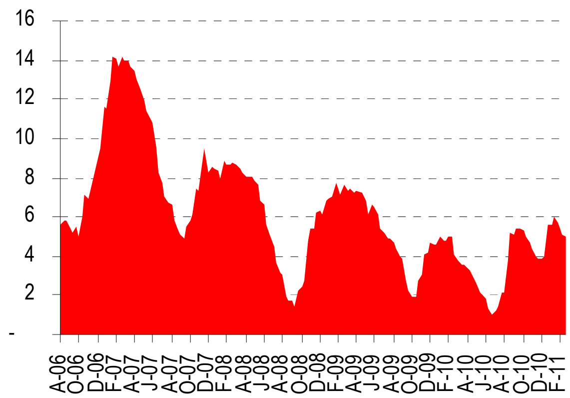
- **China tightens.** On 24 Feb, the People's Bank of China raised the reserve requirement ratio by 50bp to 19.5% in the fifth consecutive increase since Oct 2010. The government also imposed a series of regulations to curb the rise in property prices including property taxes in Shanghai and Chongqing, higher lending rates and restrictions on second and third homes.
- **QE3 unlikely.** Going by recent comments by Federal Reserve officials, the US Fed's US$600bn bond purchases could end in June 2011. Our economic research team believes that bond markets have not priced in further rounds of quantitative easing, suggesting that the Federal Open Market Committee is likely to emphasise risks to growth instead of inflation in upcoming meetings.
- **Car sales.** On 8 Mar, the China Passenger Car Association reported that Feb 2011 sales of passenger cars and minivans declined 0.4% yoy to 880,027 units due to an increase in the sales tax rate for small cars from 7.5% to 10%, lower subsidies for vehicle trade-ins in rural areas and higher petrol prices.
- **Natural disasters.** On 11 Mar, a 9.0 magnitude earthquake struck Japan, stirring fears that the disaster may hurt the economy and weaken global demand for raw materials. On that day, Tokyo rubber futures for Aug 2011 delivery fell 3.2%.

Figure 14: Rubber inventory tracked by the Shanghai and Tokyo exchanges ('000 t)

Shanghai Futures Exchange



Tokyo Futures Exchange



Source: Company, CIMB Research, Bloomberg, Shanghai Futures Exchange, Tokyo Commodity Exchange

Additional supply from non-conventional sources. We also believe that the rubber correction is due to higher supply from non conventional sources such as 1) intensified tapping, 2) higher yields, and 3) deferred replanting.

- **Intensified tapping** – During periods of high prices, farmers undertake short-term yield-enhancing measures to maximise earnings. These include use of stimulants and installing rain guards.
- **High yield clones** – While first-generation rubber clones take 5-6 years to reach yield age, new high-tech clones start yielding in 4-5 years. In Malaysia, 50% of new plantings reach maturity in 4-5 years but authorities aim to increase this to 70% by 2015 and 100% by 2020. Also, R&D is being conducted to raise yields from 1,450kg per ha to 1,750 kg per ha by 2015 (+21%) and 2,000kg per ha by 2010 (+38%).
- **Replantings deferred** – At RM16.00/kg of solid rubber (or RM10.65/kg for latex concentrate), we estimate farmers earn cash profits of c.RM7,200 per acre. This implies that 10 acres would earn profits of c.RM72,000 per annum or c.3.3x above Malaysia's per capita income of RM22,000. With earnings high above the nation's average, we expect farmers to postpone replanting programmes to maximise incomes.

Glovemakers' take on latex price trend. Top Glove has been most aggressive, with MD Lee Kim Meow saying on 12 Jan 2011 that prices would drop to RM5.00/kg within six months (12 Jan price: RM9.85/kg). On 16 Feb 2011, Supermax's CEO Dato' Seri Stanley Thai said he expects rubber latex to average RM7.50/kg in CY11, implying a drop from the RM10.60/kg price at the time. Finally, Kossan's internal KPIs are based on a rubber latex price of RM9.00/kg.

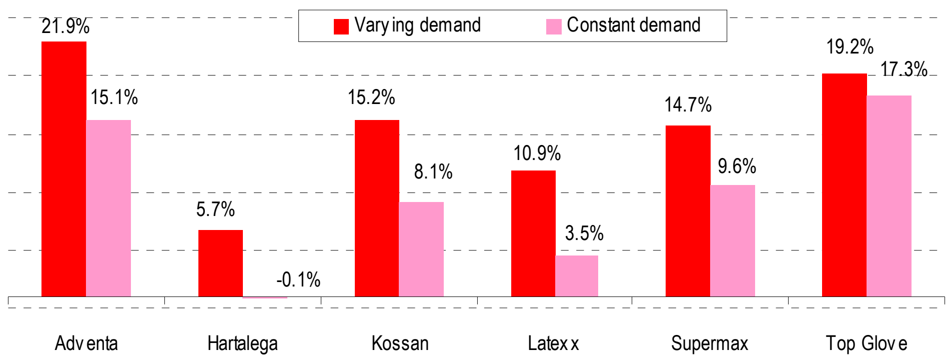
Sensitivity analysis

Impact of lower rubber prices. A sustained contraction of rubber prices would enable glovemakers to claw back profits as higher selling prices lag behind feedstock purchases. It also lowers working capital requirements and helps build reserves.

Scenario analysis. We work on two scenarios – a bearish case where demand remains constant and independent of selling prices and a more realistic scenario where buying behaviour adjusts to ASPs.

- Constant demand scenario:
    - +/- 10% change in natural rubber latex price;
    - +/- 10% change in nitrile latex price;
    - 50% cost / savings pass-through (weighted for product mix); and
    - no change in utilisation rates;
- Varying demand scenario:
    - +/- 10% change in natural rubber latex price;
    - +/- 10% change in nitrile latex price;
    - 50% cost / savings pass-through (weighted for product mix); and
    - +/- 5% pt change in utilisation rates.

Figure 15: Net profit sensitivity to higher input price assumptions (% increase/decrease from base)



Source: Company, CIMB Research, Bloomberg

Hartalega's superior cost structure... Our sensitivity suggests that Top Glove, with its high cost structure (c.90-100% rubber mix) is most leveraged to changes in input price assumptions. At the other end of the spectrum is Hartalega, which is least exposed to cost changes due to its better cost structure.

…helps company de-risk earnings growth. As Figure 15 shows, because of Hartalega's low cost, the company's earnings only change if demand responds to ASP changes. While the low sensitivity is a negative in a deflationary environment, it shields the company from higher costs and external shocks.

Top Glove most leveraged to rubber price movement. While Top Glove is rated a Neutral on fundamental grounds, the company's low profit margins make it the most leveraged to rubber price volatility. This means that Top Glove's share price will outperform its peers if rubber prices fall. Also, Top Glove is a liquid stock, making it easily tradable and a good hedge against falling rubber prices. Supermax is also considered a liquid instrument with the highest beta in our universe. Like Top Glove, we expect its share price to respond well to input price volatility.

Figure 16: Cost structures and liquidity

CY 2011F	Profitability metrics		Liquidity and volatility metrics			
Glovemaker	Net margin (%)	Cost / Rev (%)	Foreign Hldg (%)	Free Float (%)	5d ATV (RM '000))	Beta (vs. KLCI)
Adventa	10%	-90%	8.0%	46%	520.5	1.48
Hartalega	28%	-72%	5.0%	42%	1,084.9	0.99
Kossan	12%	-88%	7.2%	42%	1,635.5	0.95
Latexx	20%	-80%	6.6%	54%	1,532.8	1.66
Supermax	19%	-81%	19.7%	55%	6,374.2	1.67
Top Glove	10%	-90%	32.0%	53%	8,541.7	0.96
Average	**16%**	**-84%**	**13%**	**49%**	**3,282**	**1.29**

Source: Company, CIMB Research, Bloomberg

Valuation and recommendation

Adjust earnings for higher costs but maintain rating. Taking our cue from higher latex prices, we raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. Overall, this lowers our FY11-12 sector net profit forecasts by 8-9% (note that Top Glove's and Adventa's earnings have already been adjusted following their results announcements). Despite the lower earnings, we make no changes to our company ratings or our OVERWEIGHT call on the glove sector.

Figure 17: Changes to FY11 and FY12 net profit estimates

		FY'11 net profit			FY'12 net profit			New EPS	Recommendation		
Glovemaker	Date of chg	Old	New	% Chg	Old	New	% Chg	growth	Old	New	Chg
Hartalega	4-Apr-11	184.7	184.7	0.0%	218.5	202.9	-7.1%	9.9%	Outperform	Outperform	Maintained
Kossan	4-Apr-11	144.7	133.6	-7.7%	170.4	161.8	-5.0%	21.1%	Outperform	Outperform	Maintained
Latexx	4-Apr-11	95.7	81.3	-15.0%	104.2	91.1	-12.6%	12.1%	Neutral	Neutral	Maintained
Supermax	4-Apr-11	176.3	160.8	-8.8%	195.9	171.1	-12.7%	6.4%	Outperform	Outperform	Maintained
Overall		**-**	**-**	**-7.9%**	**-**	**-**	**-9.4%**	**12.4%**	**-**	**-**	**-**

Source: Company, CIMB Research

Figure 17: Summary of changes to Adventa and Top Glove's FY11 and FY12 net profit estimates

		FY'11 net profit			FY'12 net profit			New EPS	Recommendation		
Glovemaker	Date of chg	Pre	Post	% Chg	Pre	Post	% Chg	growth	Pre	Post	Chg
Adventa	1-Apr-11	36.6	26.2	-28.4%	47.7	45.0	-5.7%	71.5%	Outperform	Outperform	Maintained
Top Glove	17-Mar-11	248.3	159.3	-35.8%	302.9	229.7	-24.2%	44.2%	Outperform	Neutral	Downgraded
Overall		**-**	**-**	**-32.1%**	**-**	**-**	**-14.9%**	**57.9%**	**-**	**-**	**-**

Source: Company, CIMB Research

Impact on glovemakers:

- **Hartalega.** We scale back our FY12-13 net profit numbers by 5-7%. Nitrile refiners such as PolymerLatex did not raise prices in 2010 but have raised price twice YTD by 6% in Mar and US$160/mt in April. Though Hartalega will pass some costs on, the cover is imperfect. As a result, we expect net margins to decline c.1% pts to 25% in FY12 before rebounding to 27% in FY13 when efficiencies from Plant 6 kick in.
- **Kossan.** We reduce FY11-13 net profit by 5-8% after factoring in higher feedstock costs. With a 40:60 nitrile:rubber mix, the company has the best balanced product mix. This mix will change slightly as the company will move to a 50:50 mix by end FY12. We believe this diversified mix will enable the company to capture incremental demand from emerging markets, which are more price sensitive than US and EU end-users.
- **Latexx.** Though we lower our FY11-13 net profit forecasts by 6-15%, we maintain our target price of RM3.10, which is pegged to Navis's non-binding bid. Navis has until 15 May to finalise its binding bid. If accepted by Latexx, it would be tabled to shareholders. To materialise, the deal requires 75% shareholders' support.

Figure 18: DuPont analysis

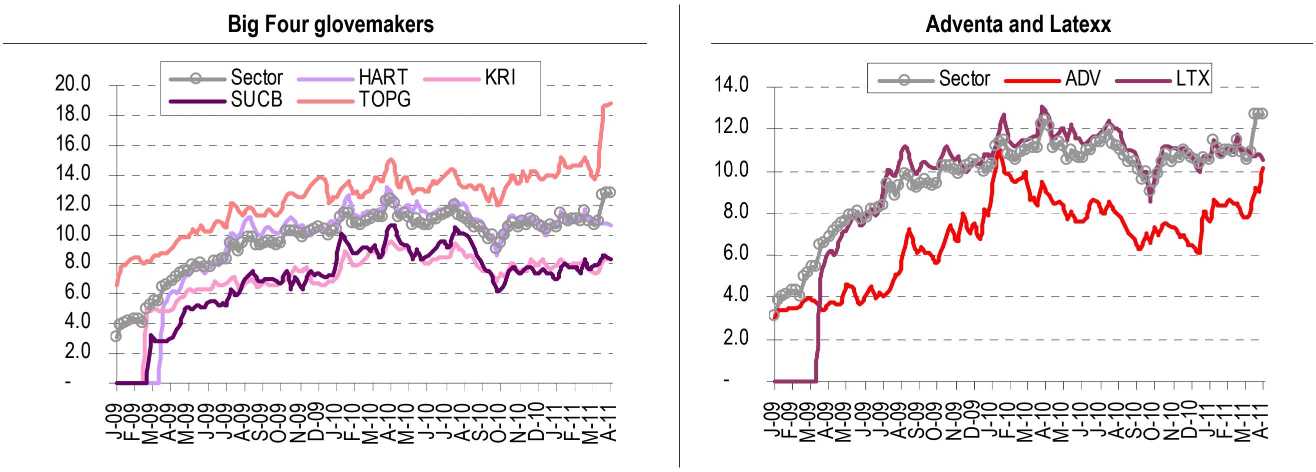
Company	Adventa	Hartalega	Kossan	Latexx	Supermax	Top Glove
Latest quarter (12 months to)	01/11 Q1	12/11 Q3	12/10 Q4	12/10 Q4	12/10 Q4	02/11 Q2
Net profit margin	8.3	26.1	11.3	14.1	18.2	8.2
Asset utilisation	0.9	1.3	1.4	1.4	0.9	1.6
Equity multiplier	1.9	1.3	1.8	1.7	1.6	1.2
ROE %	15.0	46.6	28.6	32.4	25.1	15.9
5 yr avg ROE %	14.7	47.3	26.2	38.1	29.3	24.1
ROA %	7.8	34.7	16.0	19.1	16.0	12.8
5 yr avg ROA %	7.9	33.8	13.7	20.6	16.9	18.1

Source: Company, CIMB Research, Bloomberg

Latexx arbitrage opportunity. Latexx's share price has trended down from its peak of RM2.90 when Navis launched its non-binding bid on 31 Jan 2011. Based on the bid price of RM3.10, investors stand to make a theoretical gain of c.11%. Major shareholder, Low Bok Tek has a 30% interest and requires 75% acceptances to consummate the deal. We advise rejecting the offer as it is unattractive on valuation and premium grounds.

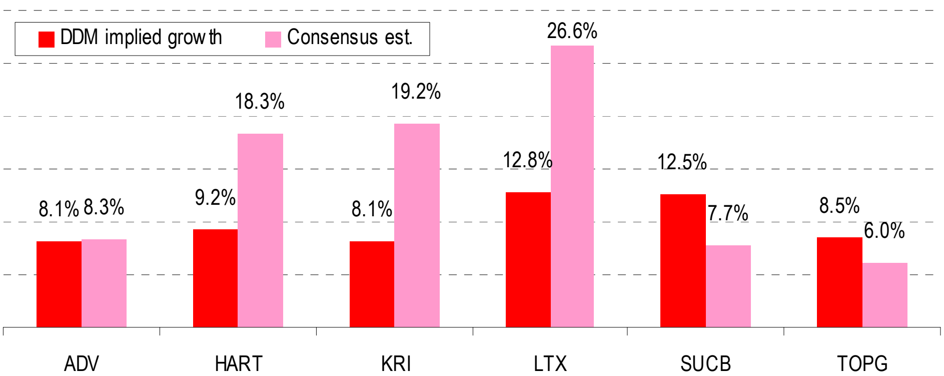
Top Glove premium unjustified. YTD, save for Top Glove, all glovemakers under our coverage saw a contraction in forward P/E multiples due to lower growth expectations. While Top Glove's share price is probably supported by expectations of an unusually high payout ratio of 60-70% for FY11 (10-year average: 25%), we view this as one-off and unsustainable. Figure 19 below shows that Top Glove's forward P/E multiple is 18x, a premium which we believe is excessive as its 3-year EPS CAGR of 7-8% is below the sector average of 14-15%. Also Figure 20 shows that Top Glove's implied growth rate (derived from our DDM model) is higher than consensus, indicating that the market is discounting a much higher growth rate than warranted.

Figure 19: Forward P/E multiples for the glove sector



Source: Company, CIMB Research, Bloomberg

Figure 20: Implied net profit growth rate versus consensus estimates



Source: Company, CIMB Research, Bloomberg

Prefer Kossan, Hartalega. For exposure to gloves, we prefer Kossan and Hartalega. Both stocks have low foreign shareholdings, making them less susceptible to fund outflows. Kossan replaces Hartalega as our top pick as we expect Hartalega's profit margins to contract on the back of competition and higher costs. Kossan, meanwhile, has higher upside due to its diversified product portfolio which enables the company to meet market demand quickly.

- **Kossan.** Kossan is the most balanced glovemaker and has consistently reported good results. The company has a 40:60 nitrile/rubber product mix, which, given increasing volatility of commodities, is paramount in meeting demand quickly. We expect FY12 net profit growth of 21%, leading to an attractive forward P/E of 6.7x.
- **Hartalega.** Hartalega stands to benefit from the continued switch to synthetics in the US and Europe. However, profitability will shrink as refiners have started to raise prices. Also, nitrile competition is rife as smaller glovemakers jump on the bandwagon. While profitability will rise when Plant 6 comes onstream, this is expected to make an impact only from FY13 onwards.
- **Maintain OVERWEIGHT.** We raise our CY11-13 nitrile price assumption by 5-7% and our CY11-13 rubber latex price by 9-10%. This lowers FY11-12 sector net profit by 8-9%. Our portfolio now has two Neutrals and four Outperforms. We maintain our OVERWEIGHT rating on the sector as headwinds have left the sector's CY12 P/E at 8.6x or 30% below the KLCI's 12.7x P/E. This is despite a 3-year EPS CAGR of 11%, which is supported by the 8-15% annual demand growth. Other potential re-rating catalysts are 1) increased outsourcing, 2) lower rubber prices and 3) earnings claw-back as higher selling prices lag rubber's decline. Kossan replaces Hartalega as our top pick as we expect lower profit margins for Hartalega and think there is more upside for Kossan which has a balanced product mix of 50:50 rubber:nitrile.

COMPANY BRIEFS…

CIMB

CIMB Research Report

Hartalega Holdings

Synthetic switch

QUICK TAKES

5 April 2011

Syariah-compliant stock

OUTPERFORM	Maintained
RM5.50	Target: RM8.25
	Mkt.Cap: RM2,000m/US$661m
	Rubber Gloves

MALAYSIA

HART MK / HTHB.KL **Terence Wong CFA** +60(3) 20849689 – terence.wong@cimb.com

Latex price changes

Taking our cue from higher latex prices, we raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. For Hartalega, we cut FY12-13 EPS by 5-7% as we do not believe it can pass on all the cost increase. We project a c.1% pt decline in net margin to 25% in FY12 before a rebound to 27% in FY13 when efficiencies from Plant 6 kick in. Demand will remain strong as Hartalega will continue to benefit from a switch to nitrile gloves in the US and EU. Our earnings cuts reduce our target price from RM8.43 to RM8.25, still based on a forward P/E of 13.05x or a 10% discount to Top Glove's target of 14.5x. Hartalega remains an OUTPERFORM. The stock could be catalysed by emerging market orders, efficiency gains and higher selling prices.

Comments

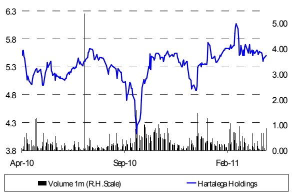
Nitrile feedstock rising. We scale back our FY12-13 net profit numbers by 5-7%. Nitrile refiners such as PolymerLatex did not raise prices in 2010 but have raised price twice YTD by 6% in Mar and US$160/mt in April. Though Hartalega will pass some costs on, the cover is imperfect. As a result, we expect net margins to decline c.1% pts to 25% in FY12 before rebounding to 27% in FY13 when efficiencies from Plant 6 kick in.

Demand from emerging markets. Hartalega's current product profile is 90% nitrile and 10% rubber, up from 83:17 in 2Q11. The higher nitrile percentage is due to better-than-expected demand from emerging markets such as Brazil and China. Nitrile gloves can be c.20% less expensive than rubber gloves and appeal to price-sensitive consumers in Latin America and Asia.

Valuation and recommendation

Maintain OUTPERFORM. Despite our 5-7% EPS downgrades for higher feedstock costs, we continue to like Hartalega as it is well-positioned to benefit from continued switching in the US and EU. Also, the company is operating at a high utilisation rate of 85% and will be able to optimise operations to offset some of the negative impact of higher costs and price competition. After adjusting for higher costs and lower margins in FY12, we lower target price from RM8.43 to RM8.25, still based on a forward P/E of 13.05x or a 10% discount to Top Glove's target of 14.5x. Hartalega remains an OUTPERFORM. The stock could be catalysed by emerging market orders, efficiency gains and higher selling prices.

Price chart



Source: Bloomberg

Financial summary

FYE Mar	2009	2010	2011F	2012F	2013F
Revenue (RM m)	443.2	571.9	711.5	821.7	905.5
EBITDA (RM m)	107.9	202.7	254.2	279.1	326.2
EBITDA margins (%)	24.3%	35.4%	35.7%	34.0%	36.0%
Pretax profit (RM m)	95.5	177.8	231.1	253.8	298.7
Net profit (RM m)	84.5	142.9	184.7	202.9	238.8
EPS (sen)	23.3	39.3	50.8	55.8	65.7
EPS growth (%)	21.5%	69.1%	29.3%	9.8%	17.7%
P/E (x)	23.7	14.0	10.8	9.9	8.4
Core EPS (sen)	21.9	40.0	50.8	55.8	65.7
Core EPS growth (%)	14.7%	82.2%	27.1%	9.8%	17.7%
Core P/E (x)	25.1	13.8	10.8	9.9	8.4
Gross DPS (sen)	8.0	13.3	17.3	20.7	24.0
Dividend yield (%)	1.5%	2.4%	3.2%	3.8%	4.4%
P/BV (x)	7.9	5.6	4.1	3.1	2.5
ROE (%)	39.0%	47.0%	43.7%	35.9%	32.9%
Net gearing (%)	7.7%	N/A	N/A	N/A	N/A
Net cash per share (RM)	N/A	0.09	0.30	0.61	0.86
P/FCFE (x)	53.9	24.2	21.6	12.9	14.6
EV/EBITDA (x)	18.7	9.7	7.4	6.4	5.2
% change in EPS estimates			N/A	(7.1%)	(4.5%
CIMB/Consensus (x)			0.98	0.97	0.96

Source: Company, CIMB Research, Bloomberg

CIMB

CIMB Research Report

QUICK TAKES

5 April 2011

Syariah-compliant stock

Kossan Rubber Industries Bhd

Teacher's pet

OUTPERFORM	Maintained
RM3.28	Target: RM5.14
	Mkt.Cap: RM1,049m/US$347m
	Rubber Gloves

MALAYSIA

KRI MK / KRIB.KL

Terence Wong CFA +60(3) 20849689 – terence.wong@cimb.com

Latex price changes

Taking our cue from higher latex prices, we raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. This lowers FY11-12 sector net profit by 8-9%. For Kossan, we scale back our FY11-13 EPS by 5-8%, which reduces our target price from RM5.41 to RM5.14, still based on 10.2x forward P/E or a 30% discount to Top Glove's 14.5x target. With a 40:60 nitrile:rubber mix, Kossan is the most balanced glovemaker, which is paramount given the increasing volatility of commodities. Despite our projection of 21% net profit growth for FY12, the stock trades at attractive single-digit P/Es. Kossan remains an OUTPERFORM, with the re-rating catalysts being 1) contract wins, 2) upstream M&A, and 3) higher nitrile sales. Kossan is our new top pick due to its diversified product base, earnings growth and attractive valuations.

Comments

Consistent performer. Apart from nitrile specialist Hartalega, Kossan was the only rubber glovemaker to met our and consensus expectations during the recent reporting season. This is positive as other glovemakers failed to deliver. We believe this is due the company's balanced product mix of 50% nitrile and 50% rubber, which enables it to meet demand quickly. Also, given raw material volatility, a diversified product portfolio enables management to better manage raw material costs.

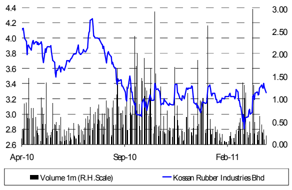
Attractive valuations. Despite our projection of 21% net profit growth for FY12, the stock trades at attractive P/Es of 8.0x for FY11 and 6.6x for FY12. By comparison, the sector is trading at average P/Es of 10.8x for FY11 and 8.6x for FY12. While other stocks may also trade at single-digit multiples, we prefer Kossan as we believe that its earnings are well supported by its balanced nitrile:rubber mix.

Upstream it goes. Management said that it may acquire plantations in Cambodia and/or Indonesia. As rubber reaches yielding age in 5-6 years, this will have no impact on gross profit. While no budget has been finalised, we expect management to fund this acquisition with internally generated funds. As at 31 Dec 2010, Kossan had RM89.9m cash and RM69.2m net debt.

Valuation and recommendation

Maintain OUTPERFORM. We raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. This lowers FY11-12 sector net profit by 8-9%. For Kossan, we scale back our FY11-13 EPS by 5-8%, which reduces our target price from RM5.41 to RM5.14, still based on 10.2x forward P/E or a 30% discount to Top Glove's 14.5x target. With a 40:60 nitrile:rubber mix, Kossan is the most balanced glovemaker, which is paramount given the increasing volatility of commodities. The company has consistently delivered good results. Despite our projection of 21% net profit growth for FY12, the stock trades at attractive single-digit P/Es. Kossan remains an OUTPERFORM, with the re-rating catalysts being 1) contract wins, 2) upstream M&A, and 3) higher nitrile sales. Kossan is our new top pick due to its diversified product base, earnings growth and attractive valuations.

Price chart



Source: Bloomberg

Financial summary

FYE Dec	2009	2010	2011F	2012F	2013F
Revenue (RM m)	842.1	1,047.9	1,395.7	1,547.6	1,699.6
EBITDA (RM m)	128.5	190.0	228.5	276.7	309.7
EBITDA margins (%)	15.3%	18.1%	16.4%	17.9%	18.2%
Pretax profit (RM m)	85.8	148.1	174.8	214.4	236.1
Net profit (RM m)	66.7	118.2	133.6	161.8	178.1
EPS (sen)	20.9	37.0	41.8	50.6	55.7
EPS growth (%)	13.7%	77.2%	13.1%	21.1%	10.1%
P/E (x)	15.7	8.9	7.8	6.5	5.9
Gross DPS (sen)	4.5	8.0	10.0	12.0	14.0
Dividend yield (%)	1.4%	2.4%	3.0%	3.7%	4.3%
P/BV (x)	2.9	2.3	1.8	1.5	1.2
ROE (%)	20.3%	28.9%	25.7%	25.0%	22.4%
Net gearing (%)	50.8%	26.8%	9.1%	N/A	N/A
Net cash per share (RM)	N/A	N/A	N/A	0.15	0.56
P/FCFE (x)	(247.6)	16.3	12.1	8.5	4.1
EV/EBITDA (x)	9.6	6.2	4.8	3.6	2.8
% change in EPS estimates			(7.6%)	(5.0%)	(5.1%)
CIMB/Consensus (x)			1.04	1.14	1.11

Source: Company, CIMB Research, Bloomberg

CIMB Research Report

Latexx Partners

Below takeover price

QUICK TAKES

5 April 2011

Syariah-compliant stock

NEUTRAL	Maintained
RM2.78	Target: RM3.10

Mkt.Cap: RM616m/US$204m

Rubber Gloves

MALAYSIA

LTX MK / LATX.KL

Terence Wong CFA +60(3) 20849689 – terence.wong@cimb.com

Latex price changes

Taking our cue from higher latex prices, we raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. Overall, this lowers FY11-12 sector net profit by 8-9%. For Latexx, FY11-13 earnings are revised down by 6-15%. But we continue to peg our target price to Navis's non-binding bid of RM3.10. Navis has until 15 May to finalise the terms, after which the offer will be tabled to shareholders. 75% acceptances are needed for the deal to go through. While we maintain our NEUTRAL rating on the stock, we note that at current levels, there is an arbitrage opportunity of c.11% assuming the deal goes through. We believe Navis's bid is too low and advise investors not to accept the offer if a binding bid of RM3.10 is tabled to shareholders.

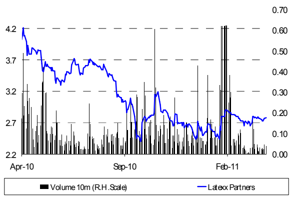
Comments

Latexx arbitrage. Latexx's share price has trended down from its peak of RM2.90 when Navis launched its non-binding bid on 31 Jan 2011. Based on the bid price of RM3.10, investors stand to make a theoretical gain of 10-11%. Major shareholder, Low Bok Tek who has a 30% stake requires 75% of shareholders' acceptances to consummate the deal. We believe Navis's bid is too low and advise investors not to accept the offer if a binding bid of RM3.10 is tabled to shareholders.

Valuation and recommendation

Maintain NEUTRAL. We raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. Overall, this lowers FY11-12 sector net profit by 8-9%. For Latexx, FY11-13 earnings are revised down by 6-15%. But we continue to peg our target price to Navis's non-binding bid of RM3.10. Navis has until 15 May to finalise the terms, after which the offer will be tabled to shareholders. 75% acceptances are needed for the deal to go through. While we maintain our NEUTRAL rating on the stock, we note that at current levels, there is an arbitrage opportunity of c.11% assuming the deal goes through. We believe Navis's bid is too low and advise investors not to accept the offer if a binding bid of RM3.10 is tabled to shareholders.

Price chart



Source: Bloomberg

Financial summary

FYE Dec	2009	2010	2011F	2012F	2013F
Revenue (RM m)	328.5	497.3	531.8	537.6	558.9
EBITDA (RM m)	66.7	101.5	122.4	138.3	162.0
EBITDA margins (%)	20.3%	20.4%	23.0%	25.7%	29.0%
Pretax profit (RM m)	51.8	84.8	101.7	113.9	133.8
Net profit (RM m)	51.3	70.4	81.3	91.1	107.0
EPS (sen)	23.5	32.1	37.2	41.6	48.9
EPS growth (%)	237.8%	37.1%	15.6%	12.0%	17.5%
P/E (x)	11.9	8.6	7.5	6.7	5.7
FD core EPS (sen)	18.7	25.6	29.6	33.1	38.9
FD core P/E (x)	14.9	10.9	9.4	8.4	7.1
Gross DPS (sen)	2.0	7.5	11.0	14.0	14.0
Dividend yield (%)	0.7%	2.7%	4.0%	5.0%	5.0%
P/BV (x)	3.6	2.6	2.0	1.6	1.3
ROE (%)	35.3%	34.5%	30.0%	26.6%	25.2%
Net gearing (%)	43.0%	19.9%	6.9%	N/A	N/A
Net cash per share (RM)	N/A	N/A	N/A	0.08	0.34
P/FCFE (x)	44.3	16.4	11.7	8.2	5.9
EV/EBITDA (x)	10.2	6.5	5.1	4.3	3.3
% change in EPS estimates			(15.0%)	(12.6%)	(6.3%)
CIMB/Consensus (x)			0.86	0.85	0.94

Source: Company, CIMB Research, Bloomberg

CIMB

CIMB Research Report

5 April 2011

Supermax Corporation

Souped-up glovemaker

RECOM	Buy
PRICE	RM4.23
MKT CAPITALISATION	RM1.44bn
BOARD	Main (Syariah)
SECTOR	Industrial
INDEX COMPONENT	KLCI, FBMSC, FBMS FBMEMAS

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Investment highlights

- **Maintain BUY.** Taking our cue from higher latex prices, we raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. Overall, this lowers FY11-12 sector net profit by 8-9%. For Supermax, this means an 8-13% downgrade of FY11-13 net profit. The company's product mix is now more balanced with 30% nitrile composition. Management is pro-rubber and though it can switch up to 48% of its production lines to nitrile, the company will stick with a 30% nitrile composition. We maintain our BUY rating on the stock though the earnings revisions reduce our target price from RM6.37 to RM5.84, still based on 11.6x forward P/E or a 20% discount to Top Glove's target P/E of 14.5x. Potential share price triggers include 1) lower rubber prices and 2) better product mix.
- **Management expects lower rubber prices.** On 16 Feb 2011, Supermax's CEO Dato' Seri Stanley Thai said he expects rubber latex to average RM7.50/kg in CY11, implying a drop from the RM10.60/kg price at the time. Management reiterated its view during our latest company visit, saying that it believes rubber latex price could drop to RM6-7/kg by July/Aug 2011.
- **Flexibility is key.** Due to the price volatility for rubber and nitrile, the ability to switch feedstocks is important. Supermax, for instance, increased nitrile production from c.24% to c.30% in a matter of months. For perspective, this is equivalent to c.1.0bn pieces of gloves. Flexibility is also important because end-users in price-sensitive markets such as Asia and Latin America have unpredictable buying patterns. These buyers tend to make decisions based on economics and have a tendency to switch quickly.

Key stock statistics

FYE Dec	2010	2011F
EPS (sen)	49.4	47.3
P/E (x)	8.6	8.9
Dividend/Share (sen)	10.0	11.0
NTA/Share (RM)	2.00	2.20
Book Value/Share (RM)	2.10	2.60
Issued Capital (m shares)		339.5m
52-weeks Share Price Range (RM)		RM2.72/RM6.60
Major Shareholders:		%
Dato' Seri Stanley Thai and family		35.6
Employees Provident Fund		8.2

Per share data

FYE Dec	2008	2009	2010	2011F
Book Value (RM)	1.20	1.60	2.10	2.60
Cash Flow (sen)	15.6	66.4	42.1	47.5
Earnings (sen)	13.8	37.2	49.4	47.3
Dividend (sen)	2.6	8.8	10.0	11.0
Payout Ratio (%)	18.8	23.6	20.2	23.3
P/E (x)	30.6	11.4	8.6	8.9
P/Cash Flow (x)	27.1	6.4	10.0	8.9
P/Book Value (x)	3.5	2.6	2.0	1.7
Dividend Yield (%)	0.6	2.1	2.4	2.6
ROE (%)	11.7	26.0	25.9	20.0
Net Gearing (%)	90.0	31.5	16.2	6.2

Source: Company, CIMB estimates, Bloomberg

For further information, kindly contact Yeoh Yung Juen at (603) 2084 9911 or yungjuen.yeoh@cimb.com

Figure 1: P&L analysis (RM m)

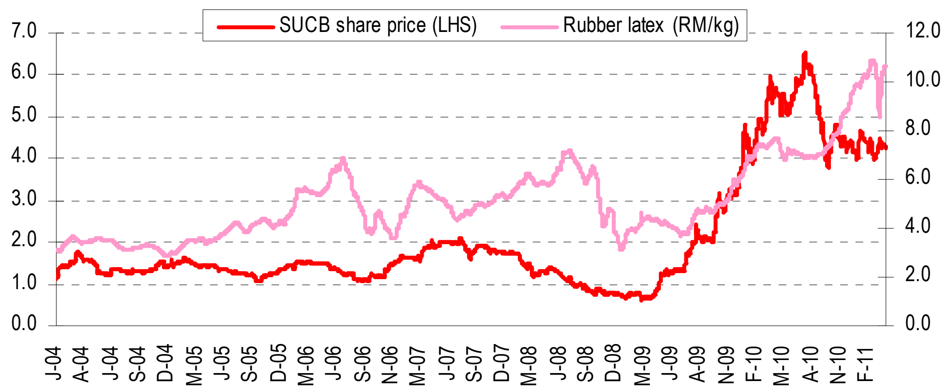
FYE Dec	2008	2009	2010	2011F
Revenue	811.8	803.6	923.3	1,141.6
Operating Profit (EBIT)	98.9	169.0	228.0	196.9
Depreciation	(28.8)	(31.9)	(34.0)	(45.6)
Interest Expenses	(20.3)	(22.3)	(11.5)	(16.2)
Pretax Profit	52.0	151.5	177.4	178.6
Effective Tax Rate (%)	*9.6*	*16.4*	*5.3*	*10.0*
Net Profit	47.0	126.6	168.0	160.8
Operating Margin (%)	*12.2*	*21.0*	*24.7*	*17.3*
Pretax Margin (%)	*6.4*	*18.8*	*19.2*	*15.6*
Net Margin (%)	*5.8*	*15.8*	*18.2*	*14.1*

Source: Company, CIMB estimates

Recommendation

Maintain BUY. We raise our CY11-13 price assumptions by 5-7% for nitrile and 9-10% for rubber latex. Overall, this lowers FY11-12 sector net profit by 8-9%. For Supermax, this means an 8-13% downgrade of FY11-13 net profit. The company's product mix is now more balanced with 30% nitrile composition. Management is pro-rubber and though it can switch up to 48% of its production lines to nitrile, the company will stick with a 30% nitrile composition. We maintain our BUY rating on the stock though the earnings revisions reduce our target price from RM6.37 to RM5.84, still based on 11.6x forward P/E or a 20% discount to Top Glove's target P/E of 14.5x. Potential share price triggers include 1) lower rubber prices and 2) better product mix.

Figure 2: Rubber latex (RM/kg) and Supermax's share price (RM)



Source: Company, CIMB Research, Bloomberg

Financial summary

FYE Dec	2009	2010	2011F	2012F	2013F
Revenue (RM m)	803.6	923.3	1,141.6	1,454.5	1,617.6
EBITDA (RM m)	169.0	228.0	196.9	215.5	248.9
EBITDA margins (%)	21.0	24.7	17.3	14.8	15.4
Pretax profit (RM m)	151.5	177.4	178.6	190.1	214.0
Net profit (RM m)	126.6	168.2	160.8	171.1	192.6
EPS (sen)	37.2	49.4	47.3	50.3	56.6
EPS growth (%)	+169%	+33%	-4%	+6%	+13%
P/E (x)	11.4	8.6	8.9	8.4	7.5
Core EPS (sen)	38.8	49.4	47.3	50.3	56.6
Core EPS growth (%)	+107%	+27%	-4%	+6%	+13%
Core P/E (x)	10.9	8.6	8.9	8.4	7.5
Gross DPS (sen)	8.8	10.0	11.0	12.0	12.0
Dividend yield (%)	2.1	2.4	2.6	2.8	2.8
P/NTA (x)	2.7	2.0	1.7	1.5	1.3
ROE (%)	26.0	26.0	20.0	18.2	17.6
Net gearing (%)	31.5	16.2	6.2	0.6	-
Net cash per share (RM)	nm	nm	nm	nm	0.31
P/CF (x)		20.3	15.1	17.7	-
EV/EBITDA (x)		6.7	7.5	6.6	5.3
% change in EPS estimates		-	(8.8)	(12.7)	(8.1)
CIMB/Consensus (x)		-	0.95	0.90	0.91

Source: Company, CIMB Research, Bloomberg

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   (a) –.

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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.	**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 stock's total return is expected to be within +/-5% of a relevant benchmark's total return.	**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.
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.	**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 stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 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 stock's total return is expected to be below a relevant benchmark's total return by 5% or more 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.

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NEUTRAL: Expected total returns of between -15% and +15% 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 +15% (or better) or -15% (or worse), or (ii) stocks that are predominantly expected to have total returns that will range from +15% to -15%; both over the next 12 months.
UNDERPERFORM: Expected negative total returns of 15% or more 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 -15% or worse over the next 12 months.
TRADING BUY: Expected positive total returns of 15% or more over the next 3 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 +15% or better over the next 3 months.
TRADING SELL: Expected negative total returns of 15% or more 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 -15% or worse over the next 3 months.

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