

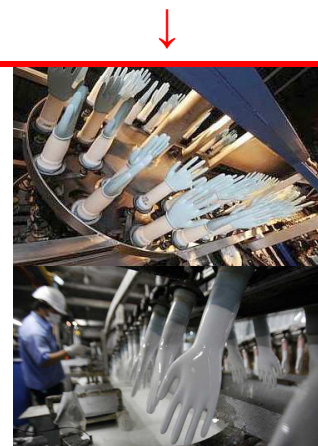
04 October 2012

# Rubber Glove

## Headwinds Ahead?

**NEUTRAL**

Against our earlier expectations, the recent sets of earnings results in the sector were somewhat below our expectations. We admit that this could be due to our much higher expectations earlier. Thus far, based on the recent sessions of the companies' analyst briefings, we gather that glove players remain cautiously optimistic in general. However, we are revising down our earnings estimates and the target prices of Glove stocks under our coverage. This is because we believe that there is a high probability that the Ringgit could continue to strengthen against US dollar, hence threatening the glove players' earnings growth going forward. In summary, we have revised our sector rating to **NEUTRAL** from **OVERWEIGHT** in the previous quarter. In line with the earnings and target prices downgrades, we have one **OUTPERFORM** call only i.e. for **KOSSAN** (TP: RM3.38) due to its undemanding valuation of <10x FY13E PER (see overleaf for details), implying a -0.5 standard deviation ("SD") below its 6-year average PER.



**2QCY12 results review.** We saw the aggregate consensus FY12E earnings improved by 3.5% after the results, thus far, showed reasonably QoQ and YoY improvements of 5.5% and 38.2% (accumulative YoY: 21.0%) respectively. These improvements were driven by lower latex prices, down 26.6% on average, and the weaker ringgit against US dollar by 3.0% in 2Q12. However, this set of quarterly results was somewhat lower or approximately 10% against our expectations. We believe this could be due to our earlier more optimistic expectations. As such, there appears to be risk for a potential downward revision in our earnings estimates.

**Will lower latex price help?** Moreover, we believe that the benefit of lower latex prices could be muted or less significant in the coming quarters, as opposed to 2Q12, should the downtrend in the latex price flatten. We understand that most of the glove players do their pricing reviews on a monthly basis. As such, to enjoy the benefit of lower latex prices, the average monthly latex price has to be lower on a MoM basis, which happened in 3QCY12. Note that gloves makers have 1-2 months time lag in passing on their additional costs to customers. The average latex prices for the month of July12, August12 and September12 were RM6.47/kg (-3% MoM), RM5.67/kg (-12% MoM) and RM5.90/kg (+4% MoM). However, going into 4QCY12, glove manufacturers may see a margin squeeze as latex prices have started to show signs of stabilising. In fact, based on our simulation study, the latex price could improve 3% QoQ to RM6.17/kg (from RM6.01/kg).

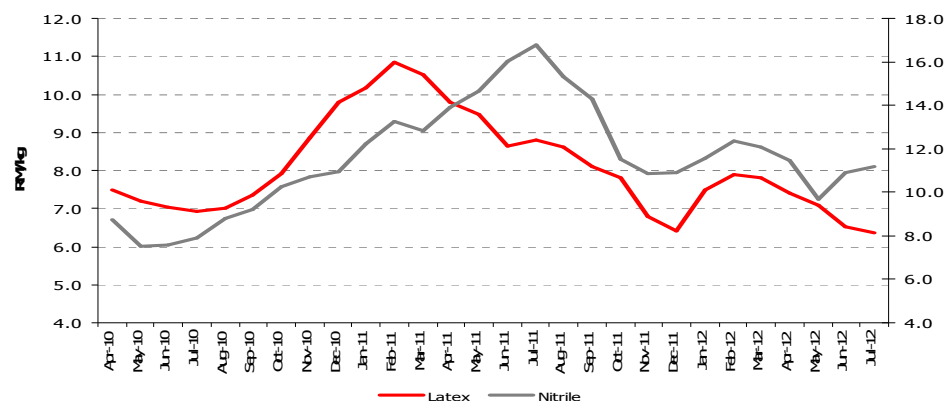
**A victim of Quantitative Easing?** Recall that the Thai Government attempted to support rubber price to above RM7.00/kg earlier this year. While latex price has been on a declining trend since early June12, the latest third round of Quantitative Easing programme ("QE3") could potentially fuel the uptrend of commodities prices. Furthermore, we also reckon that the ringgit should continue to strengthen against the US dollar with the better-than-expected deficit numbers and the anticipated weakening trend in the U.S. dollar due to QE3. These trends are generally negative for export-oriented sectors or companies, including glove makers. In fact, statistically speaking, the negative impact from weak U.S. dollar could be stronger to glove players as compared to the uptrend in the latex price.

**Fine-tuning our estimates.** After taking the aforementioned factors into consideration, we have downgraded our earnings estimates and revised our target prices for TOPGLVE (MP↓, TP: RM5.36↓), SUPERMX (MP↓, TP: RM2.20↓), KOSSAN (OP↔, TP: RM3.38↓) and HARTA (MP↓, TP: RM4.58↑) ranging from ≈2.5% to 32% down for FY12/FY13 and ≈10% to 23% down for FY13/14 (see overleaf for details). To recap, our earnings revisions factored in (i) a stronger ringgit, (ii) stabilizing latex prices as well as (iii) a lower utilisation rate due to the additional capacity and weaker demand arising from slower stocking activities in line with the higher latex price.

**Going forward,** it is believed that Malaysia's rubber glove exports will grow at a 3-year CAGR (from 2011A to 2014F) of 6.4% in volume. This growth should provide a certain degree of support to the local glove manufacturers. In fact, should we double check with the historical 3-year (from 2008 to 2011) and 9-year (from 2002 to 2011) CAGR of 10.4% and 13.0%, respectively, the expectation seems conservative in our view. Apart from capacity expansion, we also understand that glove players have also started switching more production lines to higher value-added products, i.e. thinner gloves, to cushion their margin erosions or to enhance profitability.

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Latex vs Nitrile



USD vs MYR



Source: Bloomberg, Kenanga Research

Changes in Rating and Target Prices

		Current		Previous		% of Change		Current		Previous		Target PER (x)	
		2012E	2013F	2012E	2013F	2012E	2013F	TP (RM)	Rating	TP (RM)	Rating	2012E	2013F
<u>Top Glove Corp.</u>													
	Revenue	2,288.7	2,440.0	2,280.3	2,578.1	0.4%	-5.4%	5.36	MP	5.80	OP	17	16
	Net Income	197.2	207.4	202.5	229.8	-2.6%	-9.7%						
<u>Supermax Corp.</u>													
	Revenue	977.8	1,117.7	1,177.7	1,308.6	-17.0%	-14.6%	2.20	MP	2.50	OP	12	10
	Net Income	123.5	144.8	154.4	187.6	-20.0%	-22.8%						
<u>Kossan Rubber Industries</u>													
	Revenue	1,180.6	1,251.3	1,511.7	1,724.5	-21.9%	-27.4%	3.38	OP	3.64	OP	10	9
	Net Income	113.5	122.7	137.3	143.4	-17.3%	-14.5%						
<u>Hartalega Holdings*</u>													
	Revenue	962.6	1,145.1	1,196.1	1,216.7	-19.5%	-5.9%	4.58	MP	4.42	MP	16	16
	Net Income	204.5	213.5	299.6	277.2	-31.8%	-23.0%						

\* Estimates are for FY13 &amp; FY14E

Source: Kenanga Research

Peer Comparison

NAME	Price	Mkt Cap	PER (x)			Est. Div. Yld.	Historical ROE	P/BV	Net Profit (RMm)			FY12 NP Growth	FY13 NP Growth	TP	Rating
			FY11	FY12	FY13				FY11	FY12	FY13				
	(RM)	(RMm)				(%)	(%)	(x)				(%)	(%)	(RM)	
Top Glove Corp.	5.13	3,175.2	28.1	16.1	15.3	2.7%	10.2%	2.7	113.1	197.2	207.4	74.4%	5.2%	5.36	MP
Hartalega Holdings	4.35	3,182.5	15.8	15.6	14.9	3.3%	36.2%	4.7	201.4	204.5	213.5	1.5%	4.4%	4.58	MP
Kossan Rubber Industries	3.08	984.8	11.0	8.7	8.0	2.7%	19.1%	2.0	89.7	113.5	122.7	26.6%	8.1%	3.38	OP
Supermax Corp.	2.01	1,367.1	13.1	11.1	9.4	2.8%	14.3%	1.8	104.2	123.5	144.8	18.5%	17.3%	2.20	MP

Source: Kenanga Research

**Stock Ratings are defined as follows:**

**Stock Recommendations**

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

**Sector Recommendations\*\*\***

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

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

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