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Sector Update

Rubber Gloves

Mid-Term Outlook Still Bright

OVERWEIGHT

We remain upbeat on the rubber glove sector as the operating environment seems to be favourable for glove makers for the mid-term given that (i) steady easing in price of raw materials, (ii) Ringgit remains competitive, (iii) global demand for glove still remained resilient and (iv) the potential increment in gas and labour costs may only post minimal impact to the glove makers. We are maintaining our OVERWEIGHT call on the sector with BUY for Top Glove, Supermax and Kossan while having Trading BUY for Hartalega.

Favourable raw material prices and competitive currency. The steady easing in the price of latex since April 2011 and the currently stable price appears to be working in favour of the glove makers. We believe that as long as the price of natural latex hovers between RM6.00 and RM7.00 per kg, glove makers should be able to reap robust margins. Elsewhere, the price trend for nitrile (which uses butadiene as a proxy) also appears to be encouraging. The recent fluctuations in USD have led to great volatility in rubber prices. Looking at the competitiveness of RM against other major rubber glove-exporting countries based on data, we find the RM still competitive and Malaysia still leading in the global rubber glove industry.

Glove demand still resilient and going strong. We believe the long-term demand growth for gloves is sustainable in view of the strong support from the developed countries. Emerging economies may potentially drive future demand as their populations become increasingly more aware of the importance of hygiene and as demand for higher quality healthcare services escalate. Data also shows that healthcare expenditure is on an uptrend for most countries and that may indirectly drive glove demand.

Costs may increase but still manageable. Gas and labour costs may go up in 2013 but we doubt that this would make a significant impact on glove makers' bottomlines as these costs comprise a small proportion of total costs, and such companies have been instituting measures to address rising costs.

Market share to hold, total capacity to increase. We do not think that any of the Big Four glove makers are likely to become M&A targets. However, based on valuations alone, Kossan may have a higher possibility of being such a target if we were to pick one among the four. The rubber glove companies have been ramping up their production capacity to stay competitive. We expect annual capacity growth of about 18%, or 14.2bn pieces, in 2013 and continuing expansion from here on.

Maintain OVERWEIGHT. We remain upbeat on sector as the operating environment seems to be favourable for glove makers for the mid-term. We therefore maintain our OVERWEIGHT rating for the sector with a BUY recommendation for Top Glove (TOPG MK, FV RM6.25), Supermax (SUCB MK, FV RM2.70) and Kossan (KRI MK, FV RM4.53) while having Trading BUY on Hartalega (HART MK, FV RM5.20).

Stock	Price RM	Target RM	Mkt Cap RMm	Volume '000	PER (x) FY1	PER (x) FY2	FY0 ROE %	FY1 DY %	Rel. Performance % 1-mth	Rel. Performance % 3-mth	Rel. Performance % 12mth	P/NTA (x)	Rating
Top Glove	5.58	6.25	3,454.0	969.1	16.7	15.4	17.0	3.1	9.3	2.6	19.0	2.7	BUY
Supermax	2.08	2.70	1,414.7	1,190.6	10.8	10.0	14.3	2.8	4.4	-4.5	3.2	1.2	BUY
Kossan	3.14	4.53	1,004.0	263.7	10.2	9.0	19.1	2.9	4.5	-0.7	-0.4	2.0	BUY
Hartalega	4.89	5.20	3,578.5	289.6	15.4	14.1	44.9	5.4	9.9	9.5	19.5	5.3	T.BUY

Raw material prices benign

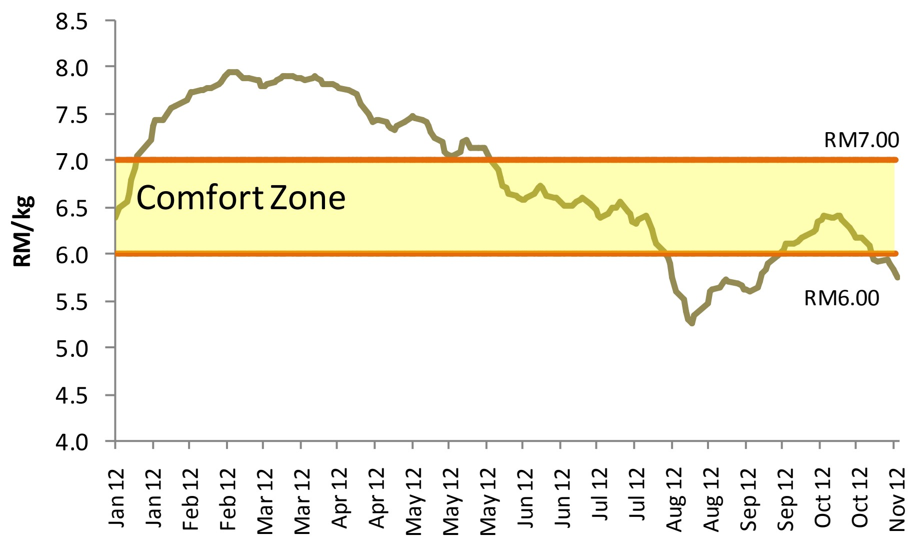
Favourable natural rubber latex price. With natural rubber latex prices stabilising in the mid-term, we believe that natural rubber glove makers should be able to maintain healthy earnings margins. Hence, the sector's mid-term outlook remains positive. That said, fluctuating latex costs could still give rise to fluctuating margins as glove makers usually adjust their selling prices on a monthly basis, although with a one- or two-month lag. Any volatility in natural rubber latex price will affect the average selling price (ASP) and impact margins. Figure 1 below shows the natural rubber latex price trend.

Figure 1: Five-year natural rubber latex price movement

Source: Bloomberg

Natural rubber latex price in comfort zone. Latex price has been easing since April 2011, falling from almost RM11.0/kg to a low of RM5.26/kg in August 2012. The recent rebound in rubber prices has sent the latex price rising above RM6.00/kg, and the commodity is now hovering at RM5.90-RM6.00 per kg. We think that the commodity's price could stabilise to the RM6.00 to RM7.00 per kg range in the mid-term, which will be favourable for glove makers and enable them to reap healthy margins.

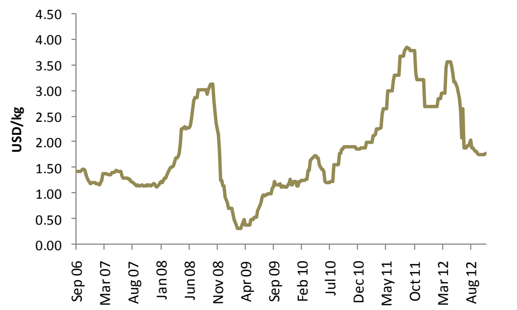
Figure 2: 2012 YTD latex price movement



Source: Bloomberg

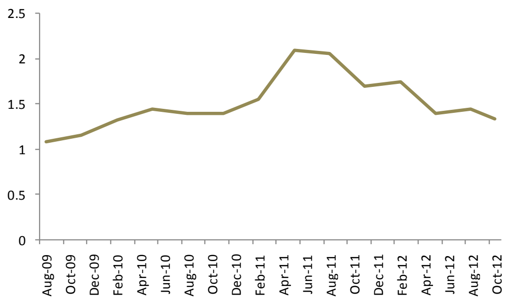
Nitrile price favourable too. Nitrile latex is made from nitrilebutadiene, acrylonitrile and other chemicals. We see butadiene, a by-product of petroleum, as a close proxy to nitrile latex price. Figures 3 and 4 show that prices actually started easing this year and are showing signs of stabilising. Such a phenomenon is to the advantage of nitrile glove makers, who will be able to reap robust margins as raw material prices recede.

Figure 3: Five-year butadiene price movement



Source: Bloomberg

Figure 4: Average nitrile price movement



Source: Top Glove

Positive for companies under OSK's coverage. Recent movements in latex prices (both natural rubber and nitrile) have been beneficial to all glove makers under our coverage. Although Top Glove and Supermax are major natural rubber glove makers, these companies have also been ramping up nitrile gloves production. Hartalega remains as one of the world's largest nitrile glove producers while Kossan has a balanced product mix of both natural rubber and nitrile gloves.

Top producers pledge price support. Earlier this year, the Thai government approved a price stabilisation scheme to support the rubber price at THB120/kg. However, the mechanism does not seem to have been effective as rubber prices have been dropping steadily over the last six months. Meanwhile, the world's top three producers, namely Thailand, Indonesia and Malaysia, had in August agreed to trim their exports this year by 300,000 tonnes, or about 3% of the global production. There are also plans to replant old rubber trees to reduce production. Although the move involves all three major rubber producing countries, we think it may still face some difficulties mainly for the following reasons: **i)** since most of the rubber producers are smallholders, as shown in Figure 5, cutting production means slashing their income, **ii)** rubber is a commodity that is traded actively on the international financial platform, which means it is open to speculation by any investor around the globe, including hedge fund managers. Thus, it would be difficult to support the commodity's price if the general market is bearish.

Figure 5: Malaysia's rubber planted hectarage by sector

Source: Department of Statistics, Malaysia

Valuations not affected by price support measures. We think the price support mechanism would not in any way affect the valuations of the four companies under our coverage. This is because our prudent natural rubber latex price assumption is above latex price's "comfort zone" in the medium-term and the target rubber price set by the Thai government is THB120/kg, which translates into a latex price of approximately RM7.10-RM7.60 per kg.

Scenario analysis. As the four companies are targeting to achieve a balanced product mix in the upcoming years, we are compelled to review our valuation models and incorporate the product mix factor into each company given that the movement of both natural rubber and nitrile latex prices will certainly have an impact on their earnings. Based on this valuation model, the impact of a 1% change in either the latex price on the four glove companies' earnings will be as follows:

Figure 6: Change in net profit for every 1% increase in latex prices

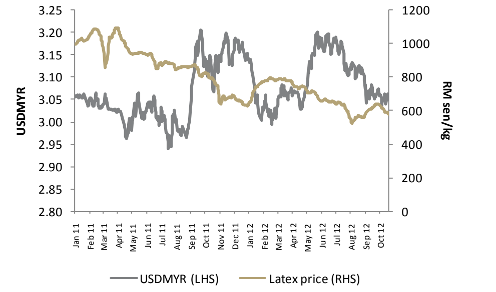
Company	Ticker	FY1 net profit (RMm)	Sensitised net profit (RMm)	Earnings change (%)	Raw materials to total cost (%)
Top Glove	TOPG MK	206.5	196.8	-4.7%	62.5%
Supermax	SUCB MK	127.6	124.2	-2.7%	63.0%
Kossan	KRI MK	98.4	94.9	-3.6%	60.0%
Hartalega	HART MK	230.3	226.8	-1.5%	68.0%

Source: OSK Research estimates

Foreign currency impact

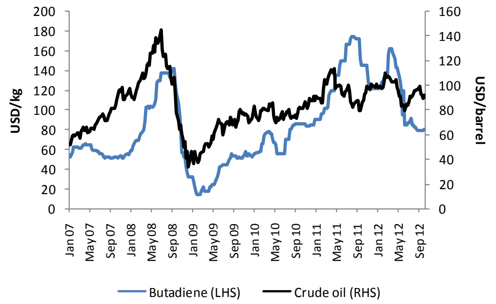
The greenback effect. As natural rubber latex is traded mainly in USD, we believe an appreciation in the currencies of natural rubber-exporting countries against the greenback will increase rubber prices in USD terms. Meanwhile, the price of crude oil, also traded in USD, will directly affect the price of nitrile, as nitrile is mainly derived from butadiene, a petroleum by-product.

Figure 7: USD-MYR and latex price



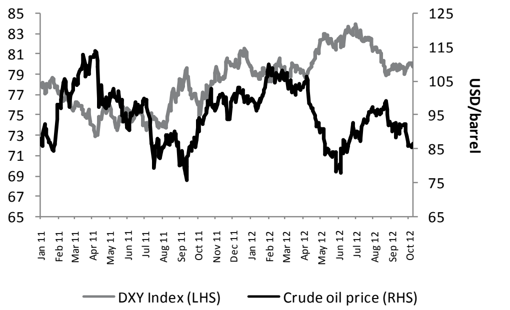
Source: Bloomberg

Figure 8: Crude oil vs butadiene price



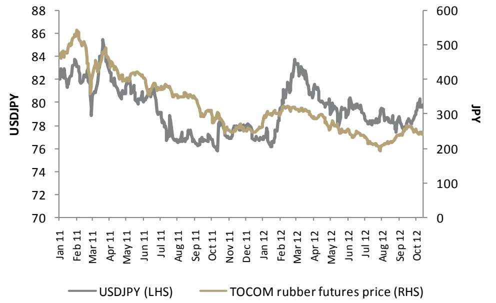
Source: Bloomberg

Figure 9: USD vs crude oil



Source: Bloomberg

Figure 10: USD-JPY vs rubber TOCOM



Source: Bloomberg

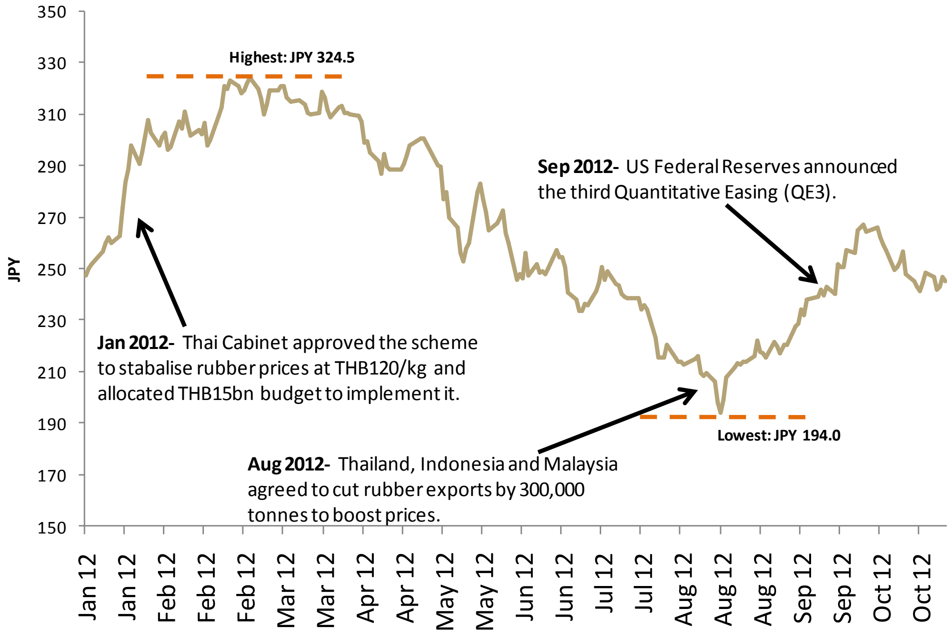
Correlation from statistical test. We notice that USD-MYR and the natural rubber latex price are negatively correlated while the price movement of butadiene is positively correlated to crude oil price. Thus, when USD-MYR strengthens, the latex price tends to decline. Likewise, when the USD strengthens against major currencies, crude oil price tends to decline. In a nutshell, commodity prices tend to decline when the USD strengthens and the converse is true when the greenback weakens. This could be explained thus – as the USD strengthens, sellers of commodities would be willing to give discounts and sell lower in USD terms as they can actually get the same value back when the deal is reconverted into their local currencies.

Rubber in the international platform. Rubber is a commodity traded on the Tokyo Commodity Exchange (TOCOM). We note that the value of the Japanese yen has a negative influence on the price of natural rubber. When the yen depreciates against the USD, speculators tend to invest in commodities, thus driving up the prices of rubber futures.

The impact on glove makers. Glove makers usually buy raw materials and trade their products in USD. If the USD strengthens over a given period, glove makers may enjoy an exchange rate gain, as the USD they will receive when selling their goods is of higher value than that used to purchase raw materials. Additionally, as shown in our statistical test, raw material prices tend to decline with as the USD strengthens, and this in turn favours glove makers. Conversely, if the USD weakens over a given period, the opposite will occur.

QE3 weakens USD but rubber price rebounds. In Sept 2012, the US Federal Reserve announced the third Quantitative Easing (QE3) to spur the American economy by purchasing USD85bn in bonds each month for the rest of 2012. In 2013, the Fed plans to continue purchasing USD40bn per month of mortgage-backed securities indefinitely until it believes the economy no longer requires such support. These measures have weakened the USD against major currencies but spurred a rally in commodity prices abroad, including the rubber price, as traders/speculators held the view that more liquidity would flow into the financial system.

Figure 11: TOCOM rubber futures price movement in 2012



Source: Bloomberg

RM remains competitive. As shown in Figure 12, the currencies of most major rubber glove-producing countries have also appreciated against the USD. Thus the competiveness of Malaysian exports is retained and the nation maintains its leading position in the rubber glove industry by commanding approximately 60% of global glove capacity.

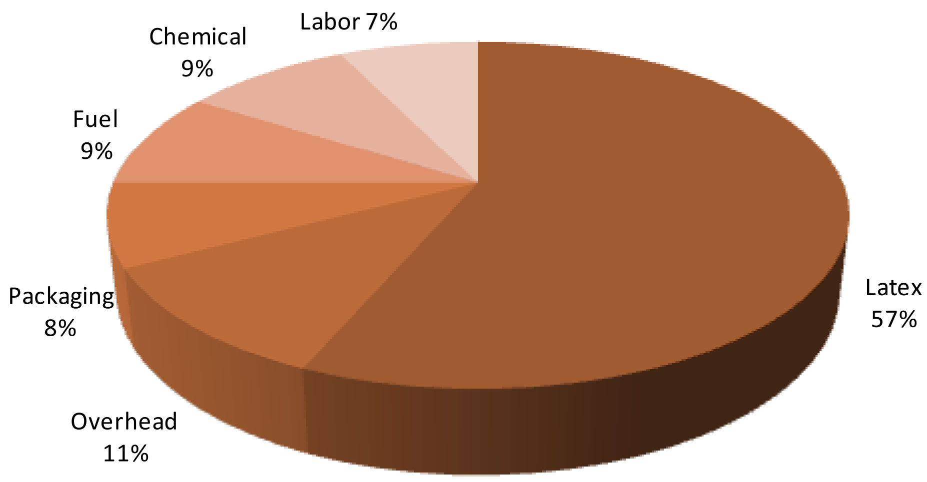
Figure 12: Local currency vs USD (2008 as base)

	Aug 2012	Sep 2012	Oct 2012
Malaysian Ringgit	9.5%	11.4%	11.4%
Thai Baht	9.8%	11.2%	11.4%
Indonesian Rupiah	15.5%	15.3%	15.0%
Chinese Yuan	7.0%	7.9%	8.5%

Source: Bloomberg, OSK Research

Impact of other costs

Figure 13: Cost breakdown



Source: OSK Research estimates

Other costs evenly spread. While latex prices make up 50%-60% of the cost structure for all glove makers, the rest of the costs such as labour, fuel (natural gas), packaging and other overhead costs are spread out evenly, each making up roughly 8%-10% of the total cost structure.

Gas cost. The Malaysian government has initiated a move to withdraw natural gas subsidies gradually to align local gas prices to the market price. However, the gas price was not revised upwards in the last two reviews and we believe the status quo will be maintained in the upcoming review on 1 Dec. We think that gas price may only be revised after the country concludes its 13th General Election. As investors may be concerned that the higher gas cost will further squeeze glove makers' margins, we carried out a sensitivity analysis on the assumption of a 1% gas price hike in the next financial year. The impact is actually minimal, as shown below.

Figure 14: Change in net profit for 1% increase in gas cost

Company	Ticker	FY1 net profit (RMm)	Sensitised net profit (RMm)	Earnings chng (%)	Gas cost to total costs (%)
Top Glove	TOPG MK	206.5	205.8	-0.3%	9.4%
Supermax	SUCB MK	127.6	126.8	-0.6%	11.5%
Kossan	KRI MK	98.4	97.9	-0.5%	9.3%
Hartalega	HART MK	230.3	230.0	-0.1%	9.0%

Source: OSK Research estimates

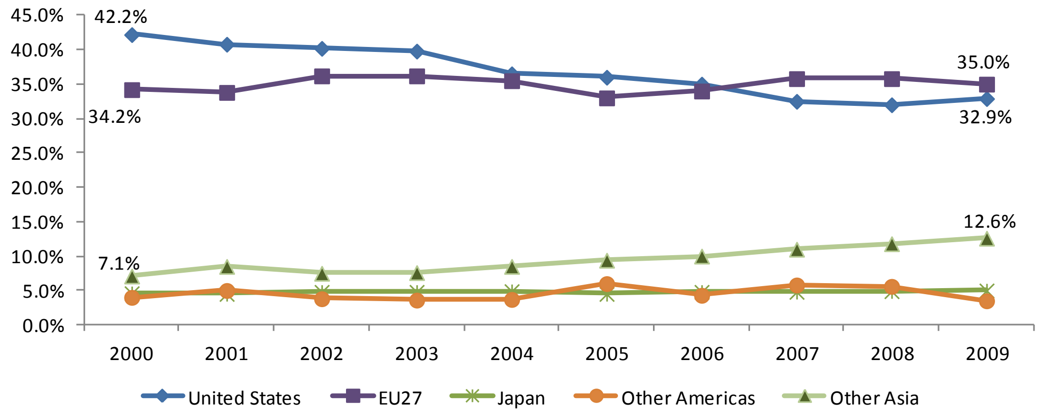
Labour costs. Investors may be concerned that the increase in labour costs following the implementation of the minimum wage policy may squeeze glove makers' margins. Starting from Jan 2013, the monthly minimum wage will be RM900 in Peninsular Malaysia and RM800 in Sabah and Sarawak. In our opinion, Top Glove may be the most affected and Hartalega the least impacted owing to its innovation in automating its production lines.

Cost hikes still manageable. Having said that, we think the hike in gas and labour costs will not be much of a concern as our analysis shows that the impact to their bottomlines will not be that significant. Therefore, we maintain our valuations for the four glove-making companies under our coverage. The companies had in fact already invested in automated production lines to cut the reliance on labour and over the long-term, the savings from automating production is enough to cover labour cost hikes. They may even generate a surplus due to the higher production efficiency achieved through automation. Besides, glove makers can use biomass energy as an alternative to natural gas, as a measure to mitigate the impact of higher gas prices.

Demand for gloves intact

Strong demand from developed countries. Based on the data from Malaysian Rubber Export Promotion Council (MREPC) in the 5th International Rubber Glove Conference & Exhibition 2010, the US and EU27 accounted for 11% of the world's population but used 68% of total gloves manufactured. In contrast, the rest of the world accounted for 89% of the population but used only 32% of gloves produced globally. We believe the US and EU27 will continue to be strong supporters of rubber glove demand as their hygienic awareness is among the highest.

Figure 15: Share of value of rubber glove imports by country and region in 2000-2009



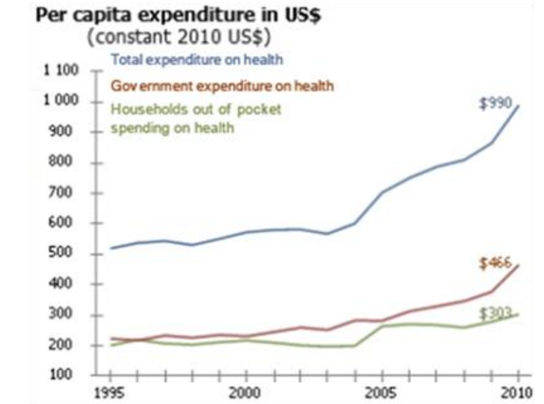
Source: MREPC

The key drivers. Moving forward, the healthcare industry would be the key driver of rising glove usage:

- **Barrier protection**
  Medical gloves are a necessity in the healthcare industry as they serve as a protective barrier against infection and disease.
- **Increased awareness**
  Especially in the emerging countries, including the BRIC (Brazil, Russia, India, China). The developed nations also have more stringent requirements now to improve healthcare quality.
- **Ageing population**
  The elderly is more susceptible to higher-risk diseases and a greater proportion of them are living longer, therefore requiring more healthcare services.
- **Health care regulations**
  Healthcare reforms in US and China, and regulations such as the Occupational Safety and Health Administration (OSHA) in the US, EU-OSHA in Europe and the Brazilian Social Services for Industry (SESI).
- **Health threats**
  Breakouts of pandemics such as H1N1, SARS and the avian flu as well as terrorist threats (Anthrax).

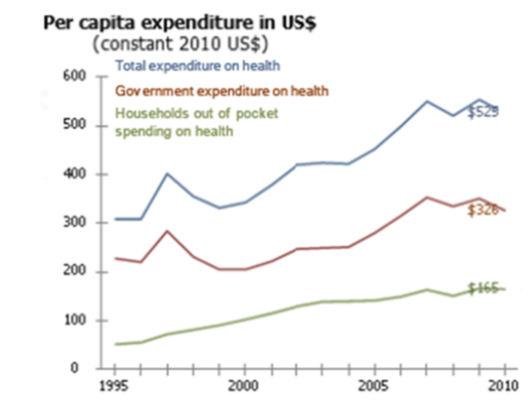
Emerging countries will fuel future glove demand. We believe that the emerging countries, especially BRIC, may be ramping up the demand for gloves globally. As their economies grow, their healthcare and hygiene requirements will be increasingly more stringent. Information from the World Health Organization (WHO) indicates that these countries have been increasing their healthcare expenditure in 2000-2010 and we believe the momentum will keep growing in the future as they develop. As more hospitals are built, more healthcare workers (doctors, nurses and general workers) will be required and thus, more medical standard gloves will be used in the upcoming years.

Figure 16: Health expenditure in Brazil



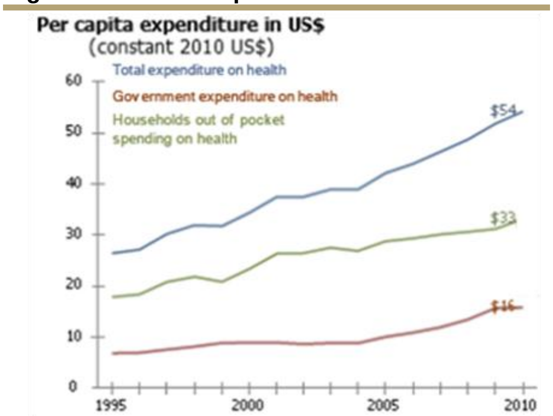
Source: WHO Global Health Expenditure Atlas

Figure 17: Health expenditure in Russia



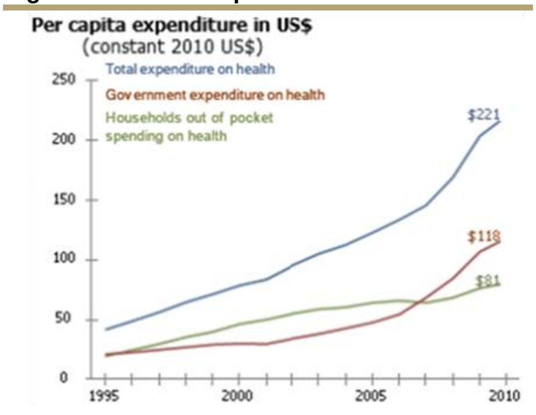
Source: WHO Global Health Expenditure Atlas

Figure 18: Health expenditure in India



Source: WHO Global Health Expenditure Atlas

Figure 19: Health expenditure in China



Source: WHO Global Health Expenditure Atlas

China healthcare reforms. In 2009, China's government announced an RMB850bn (or USD123.4bn) three-year healthcare reform plan to build clinics in 700,000 villages and raise hygiene standards. This year, the government announced the completion of the nation's healthcare system overhaul. The increase in the number of healthcare centres in China and the expansion of its primary-healthcare facilities would possibly inject a new growth of demand for gloves.

Brazil to give healthcare system shot in the arm. From market intelligence, we learnt that Brazil - already one of the countries with the highest rubber glove consumption - is expected to increase healthcare consumption between 2012 and 2016, ahead of the country hosting the 2014 World Cup and 2016 Olympic Games. The continued growth has also been supported by the government's initiatives to allocate more funding to the healthcare industry.

Global demand growth of 8%-10% p.a. justifiable. Historical data shows that the demand for gloves had been growing at an average rate of 8%-10% p.a. and the broad market expects the trend to continue. We believe the strong demand from developed countries, coupled with the increasing healthcare expenditure from emerging economies, justifies such growth rates. In keeping with our conservative valuation, we are assuming an 8% annual growth in our estimates.

Capacity expansion

Malaysia still in the lead. Malaysian glove makers account for approximately 60% of the global glove capacity and we believe this position was achieved through the combination of the proximity to key raw materials, good infrastructure, R&D, development of supporting industries and support from the government agencies. Glove makers in general realise that they need to expand their capacity, not only in terms of production but also in product mix to stay competitive. They have rolled out a series of expansion plans:

- **Top Glove**
  It currently has 21 factories producing 40bn pieces of gloves and is building three new factories, which will bring total capacity to 44.5bn by 2013. The company has also indicated a RM3.0bn investment has been set aside for capacity expansion, R&D and possible M&A exercises over the next 15 years. Apart from that, Top Glove is also the only company among the Big Four that has ventured upstream to rubber tree plantation by acquiring 95% of PT Agro Pratama Sejahtera in Indonesia.

- **Supermax**
  The company plans to increase its surgical glove production to 336m pairs in 2012/2013 from 30m pairs currently, with new lines to be commissioned at one of its factories, Lot 42. The company also intends to expand its nitrile gloves capacity from 5.2bn pieces p.a. to 10.5bn pieces p.a., which will account for 52% of its product mix by 2013. It targets to hit 21.6bn in annual capacity by end-2013.

- **Kossan**
  Kossan has rolled out its expansion plan for 2012-2014, focusing mainly on nitrile gloves, surgical gloves and clean room products. The expansion will add 10% to 15% of new capacity for 2012. The company aims to achieve a target capacity of 14.0bn pieces from 12.0bn pieces at the beginning of 2012 – an additional 660m pieces of surgical gloves and 1.4bn pieces of nitrile gloves. The company also planned to expand into Indonesia to grow its revenue in technical rubber products.

- **Hartalega**
  The construction of its Plant 6 commenced in January 2012 is expected to be completed by 2013. This will add 3.5bn to its current capacity of about 10.0bn pieces, bringing its total nitrile glove capacity to 13.5bn pieces p.a. The company also plans to invest RM1.5bn over eight years, starting from 2013 onwards, to construct the Next Generation Integrated Glove Manufacturing Complex (NGC) with a total installed capacity of 26.7bn pieces p.a. The completion of the NGC will expand Hartalega's total capacity to 40bn pieces p.a. by 2020.

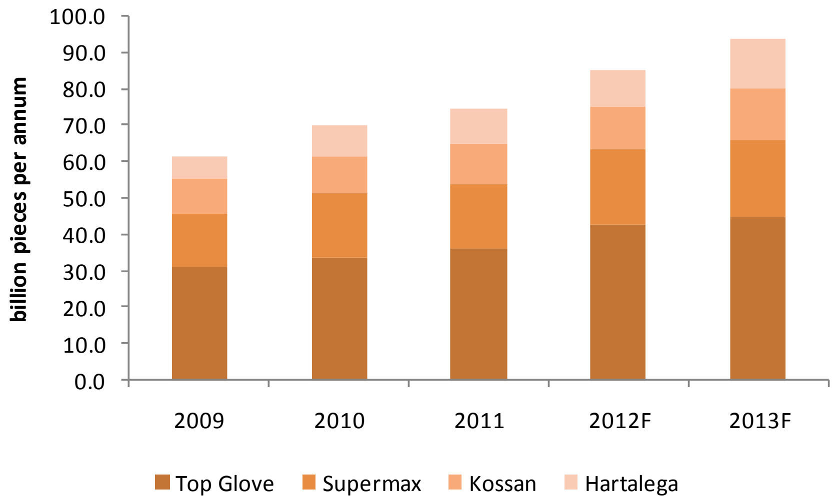
Figure 20: A snapshot of Malaysian glove makers' capacity expansion

Company	Capacity as at 2012 (bn pcs p.a)	Expansion in 2013 (bn pcs p.a)	Expected capacity by end of 2013 (bn pcs p.a)	Increment (%)
Top Glove	40.0	4.8	44.8	12.0
Supermax	17.6	3.9	21.5	22.2
Kossan	12.0	2.0	14.0	16.7
Hartalega	10.0	3.5	13.5	35.0

Source: Companies, OSK Research estimates

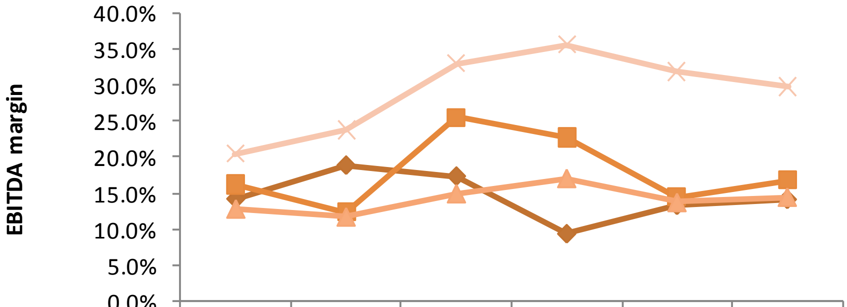
What if there is an oversupply. With all the glove makers ramping up production capacity, there is concern that there will be an oversupply of medical gloves, which will inevitably lead to margin erosion. In event of an oversupply and a prolonged downturn in the growth of demand, we believe Top Glove and Hartalega will be the two most resilient companies. Armed with their strong balance sheets, huge cash piles and low debts, Top Glove should be able to maintain a reasonable EBITDA margin of 14% while Hartalega will see above-average EBITDA margins of 30%.

Figure 21: Estimated combined capacity of the Big Four



Source: Companies, OSK Research

Figure 22: EBITDA margin trend by company



	CY07	CY08	CY09	CY10	CY11	CF12f
Top Glove	14.3%	18.9%	17.4%	9.5%	13.4%	14.2%
Supermax	16.3%	12.5%	25.6%	22.9%	14.6%	16.9%
Kossan	12.9%	11.8%	15.0%	17.1%	13.8%	14.5%
Hartalega	20.5%	23.8%	33.0%	35.7%	31.9%	29.8%

Source: Companies, OSK Research estimates

Figure 23: Net cash/(debt)

RMm	CY08	CY09	CY10	CY11	Latest quarter in 2012
Top Glove	(65)	165	259	146	164
Hartalega	(33)	(19)	33	78	165
Supermax	(211)	(183)	(86)	(108)	(98)
Kossan	(375)	(176)	(198)	(226)	(221)

Source: Companies

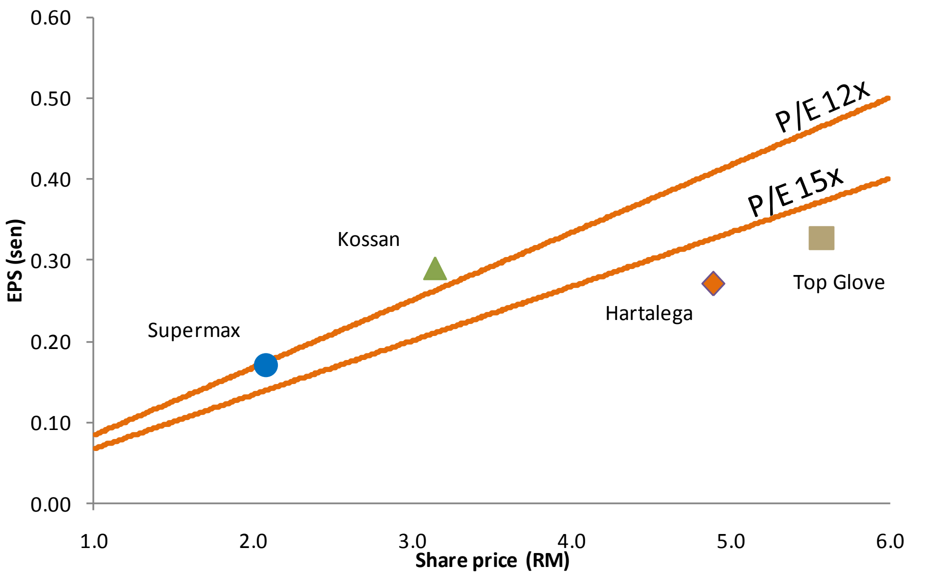
Industry in consolidation

M&As throw rubber gloves industry into the limelight. Two major corporate exercises have taken place over the last three months: **i)** the privatization of Adventa, and **ii)** the proposed acquisition of Latexx Partners by Semperit AG Holdings. With that, we concur that the rubber gloves industry is indeed in consolidation mode and think that such a phenomenon is normal and healthy for a mature industry. The glove companies have to merge to be larger and more resilient to withstand future headwinds.

The proposed deals. Adventa had, on 10 July, announced that Aspion SB – a company 30%-owned by its director Low Chin Guan and 70%-owned by Mulberry Asia Fund II LP, which is managed by Southern Capital Group – had proposed to acquire its business at RM2.10 per share. The said offer price was based on 12x PE on its FY13 EPS. Meanwhile, Semperit acquired Latexx Partners in Oct 2012 with a PE valuation of approximately 13x-14x based on its 12-months trailing EPS (including warrants).

Possible targets. Putting other factors aside and focusing only on valuations, Kossan is currently trading at 11x 12-months trailing EPS while Supermax's is at about 13x. Taking the recent two transactions as a benchmark, the PE band for any possible M&A could possibly lie between 12x and 15x PE. As per Figure 24 below, both Top Glove and Hartalega are unlikely targets due to their rich valuations. Having said that, we doubt any of the Big Four would be M&A targets. Nonetheless, if we were to choose one with the highest possibility based solely on valuation, Kossan Rubber industries would be a likely choice.

Figure 24: PE Chart



Source: OSK Research estimates

Figure 25: Theoretical price assuming trading within M&A band

Company	Last Price (RM)	PE based on TTM* EPS	FY1 EPS (RM)	Theoretical Price (RM) @ PE 12x	13x	14x	15x
Top Glove	5.58	16.9	33.4	4.01	4.34	4.68	5.01
Supermax	2.08	12.9	19.2	2.30	2.50	2.69	2.88
Kossan	3.14	10.9	30.8	3.70	4.00	4.31	4.62
Hartalega	4.89	16.8	29.2	3.50	3.80	4.09	4.38

*Note: Trailing Twelve Months

Source: OSK Research estimates

Acquisitions of smaller companies. While there are no indications of any potential M&As among the Big Four, we are of the view that these companies may acquire smaller companies if synergies could be found. With the proposed corporate exercises of Adventa and Latexx Partners, these two big names would no longer be prominent in the glove-making industry. However, we believe the market shares of other glove makers will not be affected as these consolidation moves merely reinforce the industry's fundamentals and do not introduce new entrants to compete with the existing players.

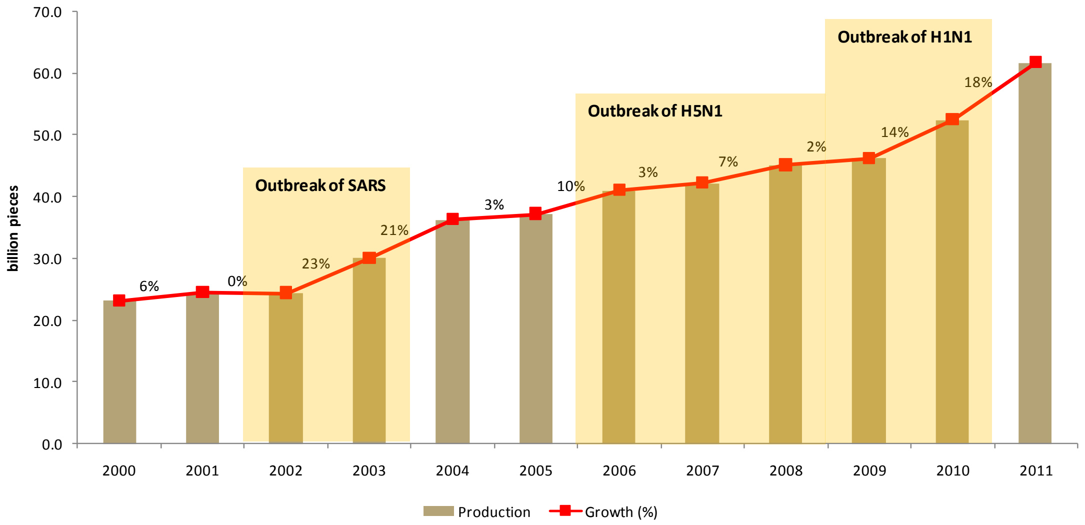
The pandemic factor

An "unpleasant" catalyst. A pandemic will certainly result in soaring demand for gloves as in what happened in 2009 when the H1N1 spread, when health authorities around the world stocked up on gloves as a precaution to contain transmission of the disease.

Top Glove ready for the worst. From the information we gathered, the company most capable of stretching its production to meet a surge in demand in event of a pandemic would be Top Glove. The company has been maintaining its production utilization at 70%-75% and is ready to ramp up its utilisation rate to meet any increase in demand.

Is a pandemic a signal to buy glove counters? Back in early October, the Ebola outbreak in the Democratic Republic of Congo raised concerns that the disease will spread. Although WHO did not issue any trade or travel restrictions to that particular country, we noticed some reaction in some glove makers' share prices, with Top Glove gaining about 5.7% in just two to three trading days. Therefore, we believe that the general market may view a pandemic as a catalyst to the rubber glove industry.

Figure 26: Glove production trend

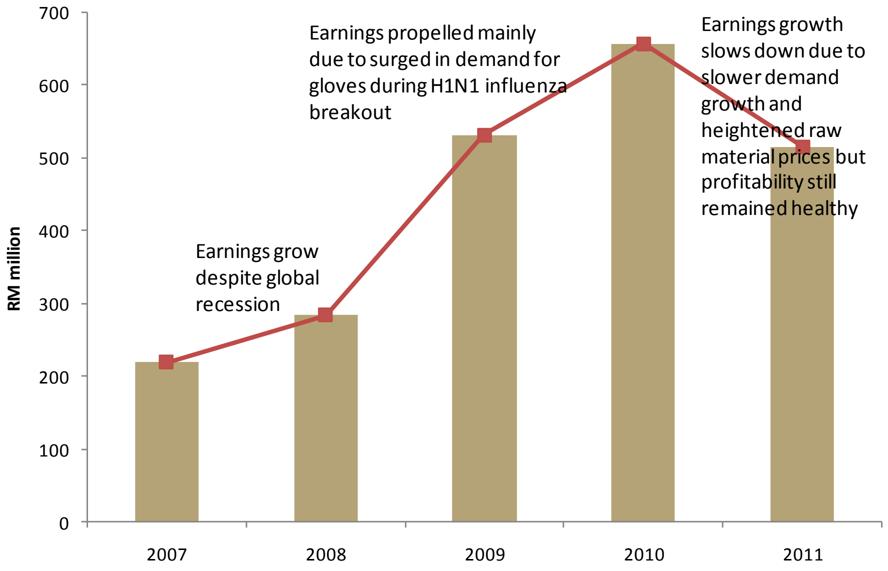


Source: Malaysian Rubber Board

Potential safe harbour during market uncertainty

A recession-proof industry? The world demand for rubber gloves is robust, as clearly be seen from global import and export data. Despite the economic recession of 2008/2009, the quantity of rubber gloves traded in 2009 showed no let-up from 2008. Also, historical data shows that the rubber glove industry is somewhat recession-proof as the companies' earnings remained healthy even during global recessions.

Figure 27: Gloves companies' earnings growth



Source: OSK Research

Strong dividend track record. Gloves companies are generally very generous in paying good dividends to their shareholders. The dividend payout policy among these companies has recently been on an uptrend. Top Glove had a 50% dividend payout ratio for FY12 ended 31 Aug 2012 (previously its dividend payout ratio policy was 40%). Supermax, in July, announced an increase in its dividend payout ratio from 20% to 30%, and Hartalega also announced that it will pay a minimum of 45% of its net earnings to shareholders. Kossan's current dividend payout ranges between 20%-25% and the Board intends to increase the payout to 35%-40% in two years.

A safe harbour for investors? Given the fact that the rubber glove industry is **i)** not cyclical in nature, **(ii)** has strong demand support and positive future growth, and **iii)** is paying good dividends and thus provides investors with a stable income stream; we think that the sector is a safe bet for investors in this volatile and uncertain global market as the slow recovery of the US economy and EU crisis continue to cast a pall on the global economy.

Maintain OVERWEIGHT. In light of the benign raw material costs and the sense that the impending higher gas and labour costs would be manageable, we remain upbeat on the performance of the rubber glove sector. Thus, we are maintaining our OVERWEIGHT rating, with BUY recommendations for Top Glove, (TOPG MK, FV RM6.25), Supermax (SUCB MK, FV RM2.70) and Kossan (KRI, FV RM4.53), while maintaining NEUTRAL on Hartalega (HART MK, FV RM4.83).

Figure 28: Snapshot of glove companies' ratings

Company	Market Cap. (RMm)	Fair Value (RM)	Earnings (RMm) FY1f	FY2f	Ratings
Top Glove	3,454.0	6.25	206.5	224.4	BUY
Supermax	11,414.7	2.70	127.6	137.8	BUY
Kossan	1,004.0	4.53	98.4	11.4	BUY
Hartalega	3,578.5	4.83	230.3	252.4	Trading BUY

Source: OSK Research

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Company Update

Top Glove Corp

Still The Top Gun

BUY

Fair Value	**RM6.25**
Previous	**RM6.25**
Price	**RM5.58**

RUBBER GLOVES

Top Glove's principal activities are in the manufacture of examination rubber gloves.

Stock Statistics

Bloomberg Ticker	TOPG MK
Share Capital (m)	619.0
Market Cap	3,454.0
52 week H | L Price	5.60 | 4.06
3mth Avg Vol (000)	969.1
YTD Returns	11.6
Beta (x)	0.98
Shariah Compliant	YES

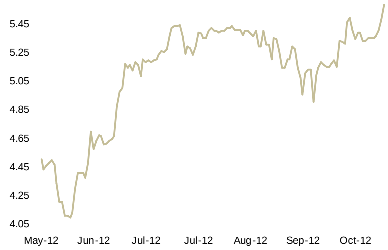
Major Shareholders (%)

Tan Sri Dr Lim Wee Chai	28.9
KWAP	5.7

Share Performance (%)

Month	Absolute	Relative
1m	6.4	9.3
3m	1.5	2.6
6m	22.1	18.6
12m	33.6	19.0

6-month Share Price Performance



Top Glove, which reported a whopping 78% y-o-y jump in net profit to RM202.2m in FY12, has ventured upstream by acquiring Indonesia's PT Agro Pratama Sejahtera. As such investments involve a long gestation period of six to eight years, we are unable to gauge the outcome at this point. However, we remain upbeat on the company's strong fundamentals and sustainable long-term growth plan. Maintain BUY for Top Glove, with FV of RM6.25, derived from 18.7x FY1/13 EPS, which is +0.5 STD from the mean of its five-year historical trading band.

Strong finale in FY12. Top Glove had recently announced stellar FY12 results, recording RM202.2m in net profit (+78% y-o-y). This figure is almost the same as what it achieved in 2009, an exceptional year marked by the H1N1 outbreak. The strong performance was mainly due to higher sales volume, competitive pricing and easing of raw material prices as well as the strengthening of the USD against the RM.

Taking the veil off its long-term expansion plan. During the analysts' briefing on 16 Oct 2012, the company's managing director Tan Sri Lim Wee-Chai guided that RM3bn will be invested over the next 15 years, mainly for capacity expansion, improving efficiency and R&D to improve product quality. Tan Sri Lim also indicated that approximately RM2.0bn of the investment has been earmarked for capacity expansion, mainly for the construction of two to three factories p.a. and to ramp up its nitrile gloves production lines.

Long gestation period for upstream venture. Top Glove had successfully acquired 95% stake in PT Agro Pratama Sejahtera, which will enable it to move upstream and maintain a stable supply of natural rubber latex to the group as well as reduce raw material costs. The initial outlay to acquire the company and land was RM22m. Tan Sri Lim indicated that Top Glove will continue to invest as much as RM230m in the plantation over the years. As it would take at least six years for the venture to produce its first rubber latex, we are not making any changes to our valuation for the moment but may do so in the longer term.

Maintain BUY. Bullish on Top Glove's future outlook, we maintain our BUY recommendation, with our FV at RM6.25, derived from 18.7x FY13 PE, which is also +0.5 STD from the mean of its five-year historical trading band. We believe the valuation is justifiable as Top Glove continues to be the leader in the medical gloves sector.

FYE Aug (RMm)	**FY10**	**FY11**	**FY12**	**FY13f**	**FY14f**
Revenue	2,079.4	2,053.9	2,314.4	2,455.1	2,638.9
Net Profit	245.2	113.1	202.2	206.5	224.4
% chg y-o-y	45.0%	-53.9%	78.8%	2.1%	8.7%
Consensus	-	-	-	213.8	240.1
EPS	39.7	18.3	32.7	33.4	36.3
DPS	16.0	11.0	16.0	16.0	17.0
Dividend yield (%)	3.1%	2.1%	3.1%	3.1%	3.3%
ROE (%)	25.6%	10.2%	17.0%	15.6%	15.3%
ROA (%)	19.6%	8.1%	13.4%	12.4%	12.3%
PER (x)	14.1	30.5	17.1	16.7	15.4
BV/share	1.77	1.81	2.03	2.25	2.48
P/BV (x)	3.16	3.08	2.75	2.48	2.25
EV/EBITDA (x)	9.1	19.6	11.4	9.4	8.2

EARNINGS FORECAST

FYE Aug (RMm)	FY10	FY11	FY12	FY13f	FY14f
Turnover	2,079.4	2,053.9	2,314.4	2,455.1	2,638.9
EBITDA	350.9	169.1	289.0	343.9	376.7
PBT	305.0	145.5	241.2	267.8	290.8
Net Profit	245.2	113.1	202.2	206.5	224.4
EPS	39.7	18.3	32.7	33.4	36.3
DPS	16.0	11.0	16.0	16.0	17.0
Margin					
EBITDA (%)	16.9	8.2	12.5	14.0	14.3
PBT (%)	14.7	7.1	10.4	10.9	11.0
Net Profit (%)	11.8	5.5	8.7	8.4	8.5
ROE (%)	25.6	10.2	17.0	15.6	15.3
ROA (%)	19.6	8.1	13.4	12.4	12.3
Balance Sheet					
Fixed Assets	627.9	707.6	785.6	822.5	826.8
Current Assets	744.1	715.4	819.6	914.5	1,072.7
Total Assets	1,372.0	1,423.0	1,605.2	1,737.0	1,899.5
Current Liabilities	218.3	229.4	284.7	281.1	294.0
Net Current Assets	525.8	486.0	534.9	633.4	778.8
LT Liabilities	37.4	47.2	40.1	39.2	39.2
Shareholders Funds	1,092.5	1,121.8	1,255.9	1,389.2	1,535.8
Net Gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

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Company Update

Supermax Corp

Downstream in Focus

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BUY

Fair Value	RM2.70
Previous	RM2.70
Price	**RM2.08**

RUBBER GLOVES

Supermax's principal activities are in the manufacture of medical rubber gloves.

Stock Statistics

Bloomberg Ticker	SUCB MK
Share Capital (m)	680.2
Market Cap	1,414.7
52 week H | L Price	2.38 | 1.63
3mth Avg Vol (000)	1,190.6
YTD Returns	8.6
Beta (x)	1.48
Shariah Compliant	YES

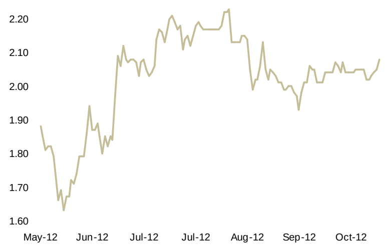
Major Shareholders (%)

Dato' Seri Stanley Thai	20.4
Datin Seri Cheryl Tan	15.1
EPF	8.8

Share Performance (%)

Month	Absolute	Relative
1m	2.0	4.4
3m	-5.5	-4.5
6m	10.1	7.0
12m	15.3	3.2

6-month Share Price Performance



Supermax, the largest own-brand manufacturer (OBM) of rubber gloves, now plans to sharpen its focus on the downstream. The company is strengthening its presence in the US by expanding its National Distribution HQ to increase its product lines, as well as capturing new markets. In view of the resilient demand in rubber gloves, declining raw material costs and better operating efficiency, we think that the group's performance should improve in 2HFY12. Maintain BUY, at our FV of RM2.70.

Largest OBM player. Supermax, which is well-known due to self-branding, is the largest OBM glove player in Malaysia, with up to 65% of its total products sold under its own brands. Operating in such a business model enables Supermax to enjoy the privilege of having dual incomes from manufacturing and distribution.

Strong presence in US. Supermax's products have a strong presence in the US, particularly in the dental sector, where it has the biggest market share in natural rubber latex gloves and fifth-largest market share in nitrile gloves. The company is aiming to increase its share in the US dental nitrile glove market to more than 10% within three years time, from the current 4.4%.

Downstream focus. Unlike Top Glove, Supermax's expansion mainly focuses on the downstream, involving global sales and marketing, distributing and making inroads into new markets via OBM. The company is currently expanding its National Distribution HQ in the US to carry additional product lines to cater to dental, science laboratories as well as to hospital markets. The company is also aiming to penetrate into new markets.

Expanding nitrile glove product mix. The company has indicated that it will ramp up its nitrile glove production lines. It targets to have a product mix of 52% nitrile and 48% natural rubber by end-2013. To achieve its target capacity of 21.6bn pieces p.a. as well as full automation for the entire group by end-2013, Supermax carried out progressive expansion plans, with new factories being constructed and old lines being replaced.

Maintain BUY, FV RM2.70. As Supermax may have enjoyed the July-Sept period of eased raw material costs and strengthened USD/RM in its 3QFY12, we think the company may be able to report decent results. In light of its solid business model and expansion plan as well as the favourable operating environment, we think our BUY recommendation at a FV of RM2.70 is justified.

FYE Dec (RMm)	FY09	FY10	FY11	FY12f	FY13f
Revenue	803.6	977.3	1,021.4	1,135.5	1,286.1
Net Profit	126.6	158.9	104.2	127.6	137.8
% chg y-o-y	-1.0%	21.6%	4.5%	11.2%	13.3%
Consensus	-	-	-	129.8	147.8
EPS	24.2	24.0	15.7	19.2	20.8
DPS	11.0	7.5	4.8	5.8	6.2
Dividend yield (%)	5.3%	3.6%	2.3%	2.8%	3.0%
ROE (%)	26.0%	25.4%	14.3%	15.7%	15.2%
ROA (%)	13.4%	15.8%	9.2%	10.2%	10.1%
PER (x)	8.6	8.7	13.2	10.8	10.0
BV/share	0.82	1.02	1.13	1.26	1.40
P/BV (x)	2.53	2.05	1.84	1.65	1.48
EV/EBITDA (x)	9.8	9.2	9.2	7.5	6.4

EARNINGS FORECAST

FYE Dec (RMm)	FY09	FY10	FY11	FY12f	FY13f
Turnover	803.6	977.3	1,021.4	1,135.5	1,286.1
EBITDA	162.9	174.7	177.4	207.4	230.5
PBT	151.5	183.8	112.1	149.1	168.5
Net Profit	126.6	158.9	104.2	127.6	137.8
EPS	24.2	24.0	15.7	19.2	20.8
DPS	11.0	7.5	4.8	5.8	6.2
Margin					
EBITDA (%)	20.3	17.9	17.4	18.3	17.9
PBT (%)	18.8	18.8	11.0	13.1	13.1
Net Profit (%)	15.8	16.3	10.2	11.2	10.7
ROE (%)	26.0	25.4	14.3	15.7	15.2
ROA (%)	13.4	15.8	9.2	10.2	10.1
Balance Sheet					
Fixed Assets	564.1	620.3	664.4	643.9	622.0
Current Assets	381.2	445.1	541.1	660.8	791.3
Total Assets	945.2	1,065.4	1,205.4	1,304.7	1,413.3
Current Liabilities	213.7	219.7	277.7	287.6	299.6
Net Current Assets	167.5	225.3	263.3	373.2	491.8
LT Liabilities	172.7	154.1	158.7	158.7	158.7
Shareholders Funds	558.8	691.5	769.1	858.4	954.9
Net Gearing (%)	31.5	28.7	29.4	16.8	6.7

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Company Update

Kossan Rubber Industries

Quality Comes First

BUY

Fair Value	**RM4.53**
Previous	**RM4.53**
Price	**RM3.14**

RUBBER GLOVES

Kossan's principal activities are in the manufacture of examination rubber gloves and technical rubber products.

Stock Statistics

Bloomberg Ticker	KRI MK
Share Capital (m)	319.7
Market Cap	1,004.0
52 week H | L Price	3.67 | 2.85
3mth Avg Vol (000)	263.7
YTD Returns	-3.4
Beta (x)	0.94
Shariah Compliant	YES

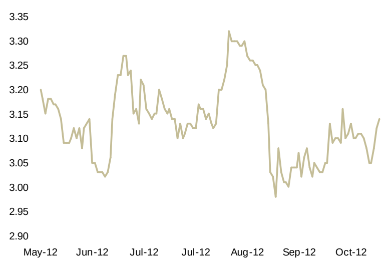
Major Shareholders (%)

Kosssan Holdings SB	50.9
KWAP	7.7
EPF	5.0

Share Performance (%)

Month	Absolute	Relative
1m	3.0	4.5
3m	-0.6	-0.7
6m	-1.9	-5.7
12m	12.7	-0.4

6-month Share Price Performance



With its balanced product mix, Kossan can tap into the natural rubber and nitrile glove markets. Its focus on delivering products to developed countries, which are generally less price-sensitive but has more stringent demands on quality, has given it a better pricing ability and made it less susceptible to cost fluctuations. Its expansion will focus on increasing product lines for nitrile and surgical gloves, and clean room products. Kossan is currently trading at 10x FY13 PE, below the industry average of 14x, and presents an opportunity to accumulate. We maintain a BUY call, with our FV at RM4.53, derived from 13x FY13 PE.

Balanced product mix. Kossan is a major OEM supplier to leading multinational companies around the world for latex medical gloves and technical rubber products. It is currently the only glove company among the Big Four that has a balanced product mix of natural rubber latex and nitrile gloves (50:50), which allows it the advantage of tapping into both markets. Recent movements in raw material prices (both natural rubber latex and nitrile latex) have also benefited the company.

Greater exposure in developed countries. Kossan has more exposure in developed countries than any of the other Big Four players. Its main market is the US and Europe, which jointly account for almost 80% of its total sales. As developed countries place more emphasis on quality over price, Kossan is able to price its products at a premium. Consequently, Kossan's product pricing is stable and less susceptible to fluctuations in raw material prices.

Expansion plan and focus. Like other glove companies, Kossan is expanding its production capacity. It expects to increase its production capacity from the current 12.0bn pieces to 14.0bn pieces p.a. by 2014. The expansion is mainly focused on expanding nitrile and surgical gloves, and clean room products. These three product types are quality-driven and thus, believed to be less price sensitive.

Trading below industry average. At its current price of RM3.08, Kossan is trading at an undemanding PE valuation of 11x FY13 PE, which is below the industry average of 14x PE. Thus, we think there is still room for its share price to rally. That, coupled with our upbeat view on the glove sector, prompted us to maintain our BUY recommendation for Kossan and our FV at RM4.53, which was derived from 13x FY13 PE. At its current price, we see a window of opportunity for investors to accumulate the stock at a lower cost.

FYE Dec (RMm)	FY09	FY10	FY11	FY12f	FY13f
Revenue	842.1	1,046.9	1,090.0	1,179.9	1,271.8
Net Profit	66.7	113.4	89.7	98.4	111.4
% chg y-o-y	13.7%	70.0%	-20.9%	9.7%	13.3%
Consensus	-	-	-	105.7	118.7
EPS	20.9	35.5	28.0	30.8	34.9
DPS	9.0	8.0	7.0	9.2	10.5
Dividend yield (%)	2.9%	2.5%	2.2%	2.9%	3.3%
ROE (%)	20.3%	28.3%	19.1%	18.5%	18.4%
ROA (%)	9.9%	15.5%	11.3%	11.6%	12.0%
PER (x)	15.1	8.9	11.2	10.2	9.0
BV/share	1.12	1.38	1.55	1.77	2.01
P/BV (x)	2.81	2.27	2.02	1.77	1.56
EV/EBITDA (x)	9.4	6.1	7.4	6.4	5.5

EARNINGS FORECAST

FYE Dec (RMm)	FY09	FY10	FY11	FY12f	FY13f
Turnover	842.1	1,046.9	1,090.0	1,179.9	1,271.8
EBITDA	126.2	178.5	150.2	171.7	190.8
PBT	85.8	140.7	112.9	125.0	141.3
Net Profit	66.7	113.4	89.7	98.4	111.4
EPS	20.9	35.5	28.0	30.8	34.9
DPS	9.0	8.0	7.0	9.2	10.5
Margin					
EBITDA (%)	15.0	17.1	13.8	14.6	15.0
PBT (%)	10.2	13.4	10.4	10.6	11.1
Net Profit (%)	7.9	10.8	8.2	8.3	8.8
ROE (%)	20.3	28.3	19.1	18.5	18.4
ROA (%)	9.9	15.5	11.3	11.6	12.0
Balance Sheet					
Fixed Assets	360.7	410.6	438.0	466.7	491.5
Current Assets	327.9	366.7	374.4	420.6	480.0
Total Assets	688.5	777.3	812.4	887.3	971.5
Current Liabilities	260.9	272.8	245.9	253.3	260.9
Net Current Assets	67.0	93.9	128.5	167.3	219.1
LT Liabilities	68.6	60.0	60.2	60.2	60.2
Shareholders Funds	357.4	442.6	496.9	565.7	643.7
Net Gearing (%)	51.3	19.5	21.8	15.4	8.5

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Company Update

Hartalega Holdings

Long Term Goals Set in Motion

Hartalega reported a decent result for its 1HFY13 but may face more earnings pressure from price competition as the emergence of more nitrile gloves capacity in the sector. That may dilute its market share as well as its ability to reap lucrative margins. Nevertheless, the company has taken measures to increase production capacity via the construction of Plant 6 and an eight-year plan to ramp up capacity to 40bn pieces p.a. We have revised upward its FY13 and FY14 earnings estimates and upgraded the recommendation to Trading BUY with FV RM5.20 in the result notes.

Price competition may pressure earnings. Price competition may become intense in the future as more nitrile gloves enter the market, largely due to Top Glove and Supermax ramping up their nitrile gloves production capacities. This could result in a dilution of Hartalega's margin, which had always been higher than average.

2 of 10 lines in Plant 6 now operating. With its capacity capped at the maximum, Hartalega had been facing a production bottleneck, unable to fully cater to the growing demand for its products. The company's production capacity increased slightly when its two of its Plant 6 lines came online recently, each with a capacity of 45k pieces per hour. The 10-line plant is expected to be fully completed next year, which would increase its total capacity by 3.5bn pieces to 13.5bn pieces p.a.

Eight-year plan to hit 40bn pieces p.a. Hartalega will start constructing its Next Generation Integrated Glove Manufacturing Complex (NGC) by December 2012. The complex will be constructed in phases over eight years, with total installed capacity of 26.7bn pieces p.a. It will also comprise an R&D centre, a renewable energy complex and training centre for the company's future long-term development. Once the NGC is completed, Hartalega's total production capacity is expected to reach 40bn pieces p.a.

Trading BUY with FV RM5.20. We have upgraded Hartalega to Trading BUY with FV at RM5.20 *(please refer to Hartalega's 1HFY13 Results Review report)* backed by its potential decent earnings in the coming quarters but with embedded risk that the intense price competition may be kicking in on 2HCY13. Nonetheless, we are of the view that the company's fundamentals remain solid and as it is aggressively expanding its production capacity, it still has good future potential.

TRADING BUY ↑

Fair Value	RM5.20
Previous	RM4.83
Price	**RM4.89**

RUBBER GLOVES

Hartalega's principal activity is in the manufacture of premium medical grade rubber gloves.

Stock Statistics

Bloomberg Ticker	HART MK
Share Capital (m)	731.8
Market Cap	3,578.5
52 week H | L Price	4.94 | 2.71
3mth Avg Vol (000)	289.6
YTD Returns	67.5
Beta (x)	0.72
Shariah Compliant	YES

Major Shareholders (%)

Hartalega Industries SB	27.6

Share Performance (%)

Month	Absolute	Relative
1m	6.9	9.9
3m	9.7	9.5
6m	23.2	19.5
12m	83.5	62.3

6-month Share Price Performance

FYE Mar (RMm)	FY10	FY11	FY12	FY13f	FY14f
Revenue	571.9	734.9	931.1	1,034.7	1,138.3
Net Profit	142.9	190.3	201.4	230.3	252.4
% chg y-o-y	69.1%	33.2%	5.8%	14.4%	9.6%
Consensus	-	-	-	227.5	255.1
EPS	19.7	26.2	27.7	31.7	34.7
DPS	20.0	21.0	18.0	28.5	31.3
Dividend yield (%)	4.1%	4.3%	3.7%	5.8%	6.4%
ROE (%)	66.4%	47.0%	44.9%	36.2%	36.5%
ROA (%)	45.1%	33.5%	34.2%	28.9%	29.8%
PER (x)	24.9	18.7	17.7	15.4	14.1
BV/share	0.57	0.80	1.00	1.04	1.08
P/BV (x)	8.54	6.12	4.88	4.71	4.53
EV/EBITDA (x)	40.3	17.9	13.4	12.2	11.1

EARNINGS FORECAST

FYE Mar (RMm)	FY10	FY11	FY12	FY13f	FY14f
Turnover	571.9	734.9	931.1	1,034.7	1,138.3
EBITDA	197.6	260.7	282.7	311.6	342.9
PBT	177.8	242.8	258.4	270.2	294.4
Net Profit	142.9	190.3	201.4	230.3	252.4
EPS	19.7	26.2	27.7	31.7	34.7
DPS	20.0	21.0	18.0	28.5	31.3
Margin					
EBITDA (%)	34.6	35.5	30.4	30.1	30.1
PBT (%)	31.1	33.0	27.8	26.1	25.9
Net Profit (%)	25.0	25.9	21.6	22.3	22.2
ROE (%)	66.4	47.0	44.9	36.2	36.5
ROA (%)	45.1	33.5	34.2	28.9	29.8
Balance Sheet					
Fixed Assets	293.0	348.9	380.2	392.2	399.1
Current Assets	185.8	286.1	377.9	395.9	421.0
Total Assets	478.9	635.0	758.1	788.1	820.1
Current Liabilities	69.0	78.9	85.5	92.4	99.1
Net Current Assets	116.8	207.2	292.4	303.5	321.9
LT Liabilities	55.5	61.3	52.6	52.6	52.6
Shareholders Funds	354.1	494.4	619.5	642.5	667.8
Net Gearing (%)	7.7	Net Cash	Net Cash	Net Cash	Net Cash

OSK Research Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated (NR): Stock is not within regular research coverage

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