MALAYSIA

Malaysia rubber gloves

Overcapacity remains an issue

We are **bearish** on the Malaysia rubber glove sector. We expect the overcapacity situation to worsen in 2H12, resulting in a lower utilization rate and weaker profit margins. In our view, with no consolidation likely in the near term, 2012 will remain a tough year, with the larger manufacturers able to weather it better.

Demand growth 8.5% < supply growth 16% = Oversupply

We expect the demand/supply gap to widen further to 13% from 6%, as production capacity grows by 16% in 2012, while demand increases by only 8.5% on our estimates. As such, we think margins will remain weak. We expect the oversupply will take at least two to three years to be absorbed by the market.

Increasing cost; margin at risk

Despite no increase in the natural gas price and electricity tariffs, as the government had initially planned for December 2011, we think that a price hike is inevitable in 2012. The Malaysian rubber glove manufacturers will have to absorb some of the cost increases to remain competitive in the international market, and we expect margins to remain under pressure as their cost advantage diminishes.

But consensus is otherwise

Our FY12 and FY13 net profit growth forecasts are 7% and 10%, respectively, below the consensus average for all three companies in our coverage. We believe that consensus is overly optimistic on the margin recovery story through increased production of higher-margin nitrile gloves. Our research shows that if more than 40% of the new capacity is for nitrile glove production, this segment will also face overcapacity issues.

All eyes on 2H12

We think that 2H12 will be the tipping point for the rubber glove sector, as most of the new installed capacity is scheduled to be operational by 1H12. We expect the manufacturers to cut selling prices to compete for market share. As the manufacturers prove unable to maintain their high growth rate, we think the sector is likely to face a derating.

No winner in a sea of red

- **Top Glove** – We are initiating coverage with an Underperform recommendation at a TP of RM4.11. It the world's largest glove manufacturer, with the largest exposure to the natural rubber glove segment which is facing with oversupply issue.
- **Hartalega** – We are initiating coverage with an Underperform recommendation at a TP of RM7.20. As the largest manufacturers in the nitrile glove segment, 2012 will be a tipping point as other manufacturers new nitrile glove production is expected to be operational.
- **Supermax** – We are initiating coverage with an Underperform recommendation at a TP of RM1.49. Despite having a distribution network, their manufacturing business is being impacted by the overcapacity issue.

Inside

Coverage snapshot

Code	Company	Mkt Cap (RM m)	PE (x)	Yield (%)	ADT (US$m)
TOPG MK	Top Glove	3,031	20.0	3.0	1.45
HART MK	Hartalega	3,048	15.1	3.3	0.58
SUCB MK	Supermax	1,313	11.0	2.7	2.14

Source: Bloomberg, Macquarie Research, March 2012
Share prices as of 28 February 2012

Recommendation summary

Company	Rec	Price (RM)	Target (RM)	Up/(Down)side (%)
Top Glove	UP	4.90	4.11	-16
Hartalega	UP	8.36	7.20	-14
Supermax	UP	1.93	1.49	-23

Source: Bloomberg, Macquarie Research, March 2012

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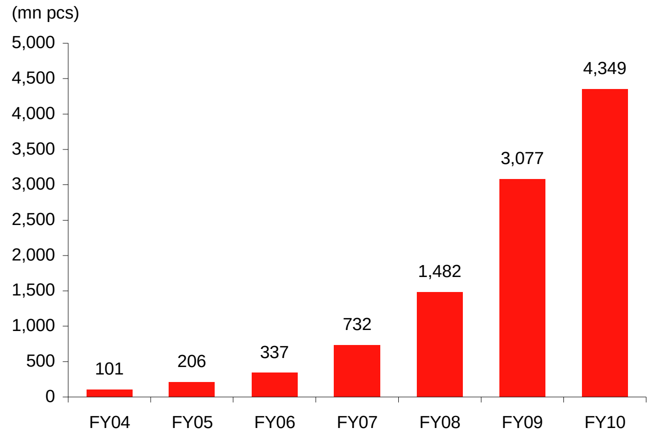
Overcapacity remains an issue for 2012

Capacity to grow by 16%

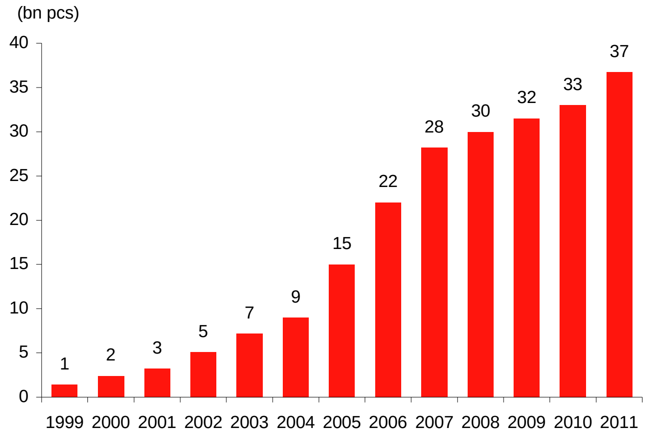
The Malaysia rubber glove sector has been on a growth spurt for the past 20 years, taking market share from MNC players such as Kimberly Clark (KMB US,US$71.85, NR) as they exited the rubber glove manufacturing business to focus on distribution and brand management. As of 2010, there were approximately 45 companies remaining in the industry, down from 200 in 1990. Malaysian manufacturers grew their global market share from 23% in 1990 to 64% in 2010, according to MREPC.

Fig 1 Hartalega's rubber glove sales grew by 43x in six years



Source: Company data, Macquarie Research, February 2012

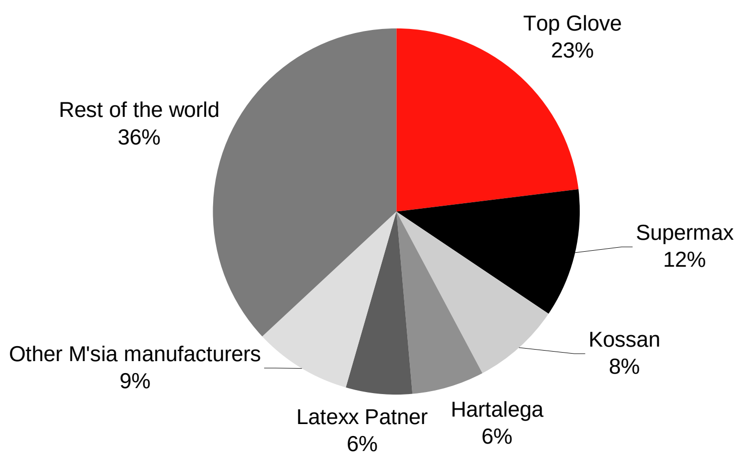
Fig 2 Top Glove's rubber glove capacity had a 29% CAGR over 12 years



Source: Company data, Macquarie Research, February 2012

Over the past ten years, Malaysian rubber glove manufacturers have been able to outbid their Indonesian and Thai competitors, despite having similar production environments, by focusing on product innovation and product pricing. This has encouraged the Malaysian manufacturers to increase their capacity to compete for a bigger market share and maintain their prime position.

Fig 3 Malaysia's top five players control 55% of the world rubber glove production capacity

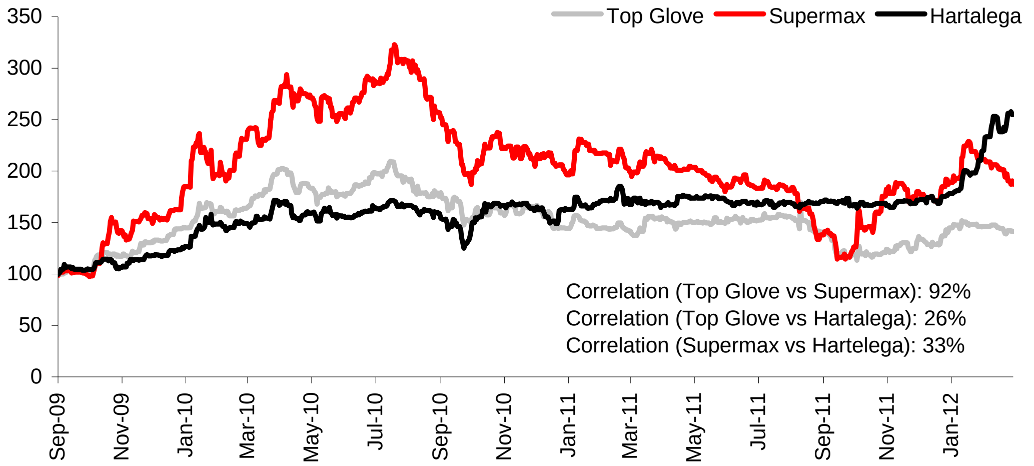


Source: MREPC, Company data, Macquarie Research, February 2012

The top five rubber glove manufacturers in Malaysia are Top Glove, Supermax, Kossan, Hartalega and Latexx Partners, which together control 55% of world rubber glove production.

But 2011 proved to be a tough year for natural rubber glove manufacturers, as consumers started to switch to a cheaper synthetic alternative, nitrile gloves.

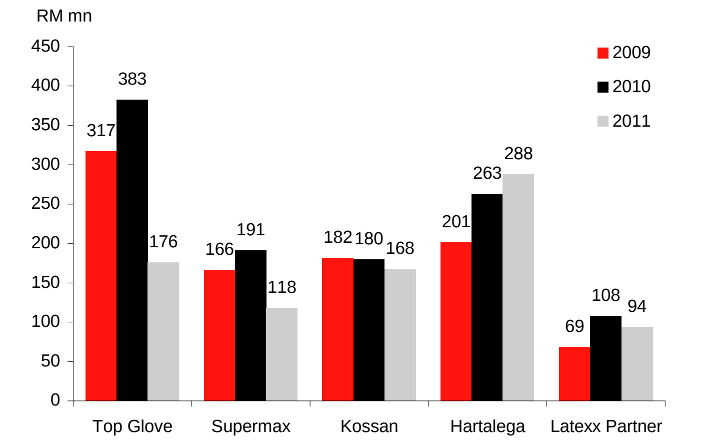
Fig 4 Top Glove and Supermax stock price performance in 2011 was lacklustre, while Hartalega managed to outperform its peers



Source: Bloomberg, Macquarie Research, February 2012

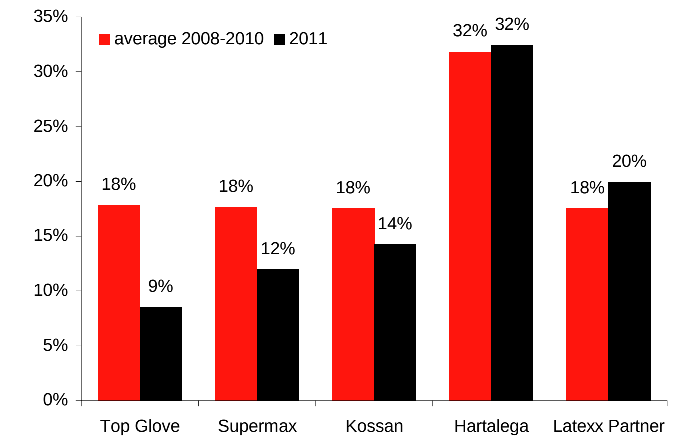
Industry sales volume grew by only 1–2%, as a higher latex price pushed rubber glove prices up. Malaysian manufacturers lowered their selling prices to maintain market share, but even so, sales volumes remain flat. We believe that oversupply has started to become a structural issue for the industry.

Fig 5 Drop in EBITDA in 2011 suggests that overcapacity will remain an issue



Supermax and Hartalega are based on Macquarie estimates
Kossan and Latexx Partner are based on consensus estimates
Source: Bloomberg, Company data, Macquarie Research, February 2012

Fig 6 EBITDA margins dropped for some manufacturers last year



Supermax and Hartalega are based on Macquarie estimates
Kossan and Latexx Partner are based on consensus estimates
Source: Bloomberg, Company data, Macquarie Research, February 2012

Oversupply remains an issue for both natural and nitrile gloves in 2012

Despite the current overcapacity, we expect rubber glove manufacturers to increase their capacity by 16% in 2012. We believe that most of this new capacity will be for nitrile gloves, in order to strike a better balance with the existing largely natural rubber latex (NRL) glove production lines. Nitrile gloves are a synthetic alternative to natural rubber gloves, and are suitable for use by people with latex allergies.

Fig 7 Capacity to grow by at least 16% next year

Company	Current Capacity	Planned Capacity
Top Glove	35.3 bn pcs p.a.	41.6 bn pcs p.a (May 2012)
Supermax	17.6 bn pcs p.a.	21.6 bn pcs p.a (Dec 2013)
Kossan	12.0 bn pcs p.a.	17.0 bn pcs p.a (Dec 2013)
Semperit AG	11.3 bn pcs p.a.	23.1bn pcs p.a (Dec 2015)
Hartalega	9.7 bn pcs p.a.	13.2 bn pcs p.a (Dec 2014)
Latexx Patners	9.0bn pcs p.a.	12.0 bn pcs p.a (Dec 2013)

Source: Company data, Macquarie Research, February 2012

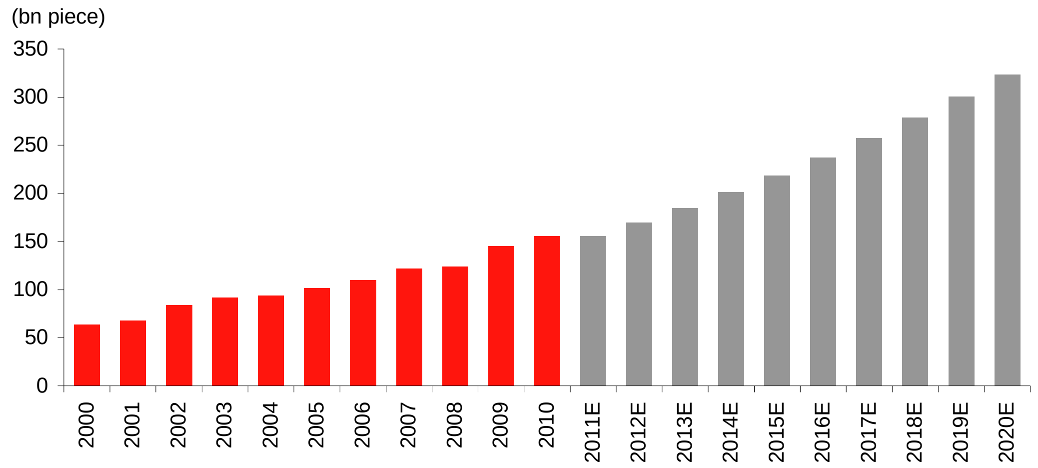
7-8% tax rebate incentivises Chinese manufacturers to compete in the international market

We think there is some upside risk to our capacity numbers as Chinese manufacturers have started producing nitrile gloves. Given the export tax incentives of 7–8% from the Chinese government, Chinese manufacturers will likely have the price advantage to make inroads into the rubber glove sector. The Chinese manufacturers are still several years behind Malaysia and Thailand in terms of production technology and efficiency, so the near-term impact is likely to be limited. However, the export tax rebate is also likely to provide incentive for new start-ups in China.

We expect demand growth of only 8.5%

We forecast rubber glove demand to reach 150bn individual gloves in 2012. The healthcare industry accounts for 80% of this. We expect demand to grow by 8.5% p.a for the next nine years, which is at the lower end of industry guidance of 8–10% p.a. This growth would be insufficient to close the supply-demand gap, as capacity is still growing – we estimate capacity growth at 16% for this year.

Fig 8 We project rubber glove demand to have an 8.5% CAGR to 2020



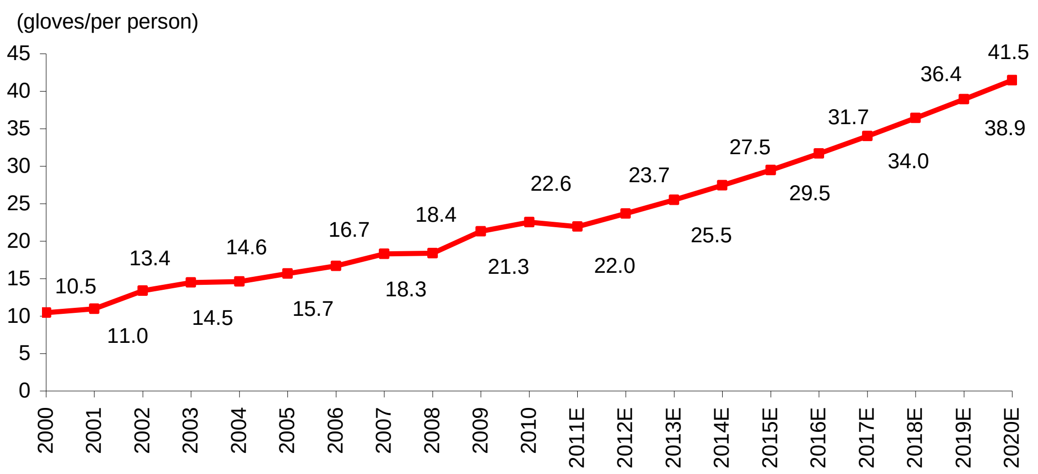
Source: MREPC, Macquarie Research, February 2012

We expect demand to continue growing at 8.5% annually, as:

Glove consumption is rising in emerging countries

- **Global population is expected to reach 7.8bn in 2020.** According to the latest United Nations data, the global population has already exceeded 7bn. As of last year, the average glove usage per person was 22.6 pieces. We expect this to increase, due to higher glove consumption in emerging countries, as people get better access to basic healthcare services.

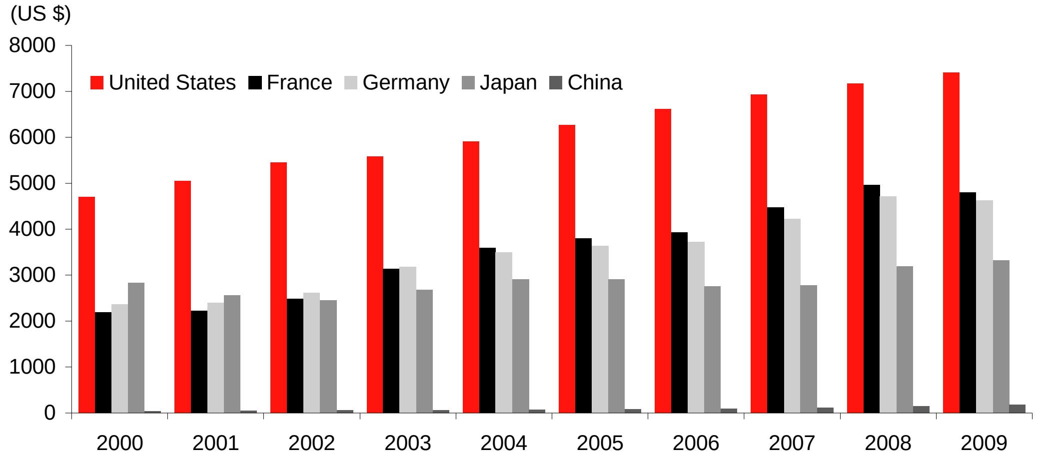
Fig 9 Annual glove usage per person



Source: MREPC, Macquarie Research, February 2012

- **Increased consumption in emerging countries.** The US and EU27 currently account for 68% of rubber glove usage, while the rest of the world consumes the remaining 32%. In terms of the rubber gloves usage per person, people in the US and EU region consume 94 pieces annually, while the rest of the world consumes eight pieces per person per year, but we forecast that this will increase as access to healthcare improves.

Fig 10 China's per capita healthcare spending is still lower than developed countries



Source: WHO, February 2012

Disease outbreaks increase rubber glove usage

- **Disease outbreaks raise awareness of the need for protection.** During the last three major global disease outbreaks, demand for rubber gloves rose by more than 10% as shown in Fig 11. We believe that governments will start to increase their glove stockpiles, supporting demand. During disease outbreaks, government officials in some emerging countries mandate that all medical professionals use rubber gloves in their daily work.

Vinyl/PVC medical glove users are switching to latex

- **The switch from vinyl/PVC to rubber-based gloves.** Most of the emerging markets prefer vinyl/PVC gloves, as they are cheaper than rubber gloves. However, research has shown that vinyl/PVC gloves offer an inferior protective barrier, even if double layers are used. We expect the switch to rubber gloves to happen gradually over the next ten years, and to have a fairly small impact, given that vinyl/PVC gloves account for less than 5% of the total examination glove market.

Industry guidance on glove demand growth is overly bullish

We believe that the industry's own growth forecast of 8–10% annually is too optimistic. We estimate that the 10% growth scenario would only be achievable in light of the following factors:

- **An increase in regional disease outbreaks.** Demand for rubber gloves has been growing at an average pace of 9.5% for the past ten years. If we take a closer look at demand growth for each year, growth of 10% or higher was only achieved during outbreaks of diseases. During normal times, the growth rate only averaged 5.6%.

Fig 11 High growth during disease outbreaks

	Glove demand (bn pcs)	Annual Growth (%)
2000	64.00	
2001	68.00	6.25
2002 (SARS)	**84.00**	**23.53**
2003 (SARS)	**92.00**	**9.52**
2004	94.00	2.17
2005	102.00	8.51
2006	110.00	7.84
2007 (Avian Influenza – H5N1)	**122.00**	**10.91**
2008	124.00	1.64
2009 (H1N1 pandemic)	**145.30**	**17.18**
2010	155.56	7.06

Source: MREPC, WHO, Macquarie Research, February 2012

- **Increase in non-healthcare usage.** The current market for PVC/vinyl gloves is estimated to be 90bn units p.a., of which 90% are used in industries unrelated to healthcare, such as manufacturing. We think that these consumers are unlikely to switch, as PVC gloves are generally 20–70% cheaper**.**

Fig 12 Vinyl is 20–70% cheaper than latex gloves

Glove type **100/box USD**	**Latex powder glove**	**Latex PF-glove**	**Nitrile PF-glove**	**Vinyl powder glove**	**Vinyl PF-glove**
Pro Medical Supplies	$6.21	$7.57	$6.81		$4.36
EQ Plus	$9.09	$8.96	$7.75		$7.40
BP Medical Supplies	$4.95	$5.00	$6.75	$4.75	$4.95
GP Supplies	$6.33	$6.33	$5.95	$3.49	
Yeap Medical	$7.25	$8.21	$7.97		
Average	$6.77	$7.21	$7.05	$4.12	$5.57
vs. Cheapest Vinyl alternative	**64%**	**75%**	**71%**		

Source: Company data, Macquarie Research, February 2012

A Chinese ban on PVC/Vinyl gloves would spur demand for latex gloves

- **Will China ban the use of PVC/vinyl gloves in healthcare services?** The healthcare market accounts for 9bn PVC/vinyl gloves p.a., and most of this demand comes from China. Although PVC/vinyl gloves offer an inferior protective barrier, we do not think that the Chinese government will enforce an outright ban on their use in healthcare. Rural healthcare facilities cannot afford the more expensive latex gloves, and China is also the main producer for PVC/vinyl gloves. However, we expect a gradual movement away from PVC/vinyl gloves over the next ten years, as China increases healthcare funding.

Fig 13 Vinyl gloves offer an inferior protective barrier

			Leakage Percentage Rates (b)		
Author	**Date**	**Durability Challenge (a)**	**Standard Vinyl**	**Latex (NRL)**	**Nitirle**
Kerr	2004	Simulated Use(c)	33.0%	9.2%	5.5%
		Simulated Use(d)	35.5%	9.0%	7.5%
Kerr	2002	Simulated Use	35.0%	9.0%	na
Korniewicz	2002	Simulated Use	8.2%	2.2%	1.3%
Rego	1999	Simulated Use	43.5%	2.0%	2.0%

(a) Simulated use, (b) When more than one brand of a particular material was evaluated, failure rates were averaged, (c) Glove Durability Method, (d) Simulated Clinical Method

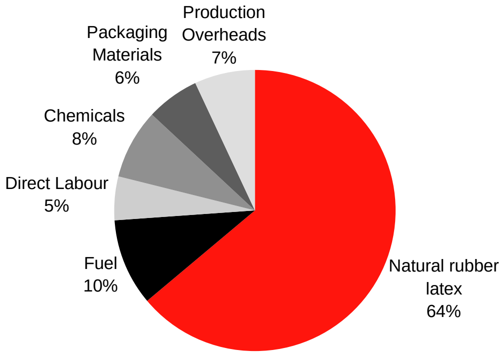
Source: Kimberly-Clark, Macquarie Research, February 2012

These factors lead us to believe that the industry forecast is overly optimistic, as it is based on a widespread switch from vinyl to latex-based gloves, and a possible regional disease outbreak within the next ten years. Furthermore, we believe that the overcapacity issue is worse than the industry guidance suggests.

Rising production cost is not helping

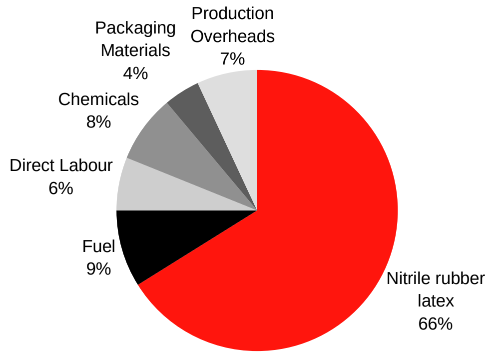
Given that the industry is facing an overcapacity issue, an increase in production cost would have an impact on the manufacturers' margins.

Fig 14 Natural rubber latex gloves cost breakdown



Source: Supermax, February 2012

Fig 15 Nitrile gloves cost breakdown



Source: Supermax, February 2012

- **Volatility in NR would lower profit margin and impact sales.** Latex comprised 60–70% of the manufacturers' production costs in 2011. Since the end of 2011, latex prices have started to trend lower due to concerns about tyre demand, which accounts for 70% of natural rubber output. However, glove manufacturers have not been able to reap most of the benefits of this, due to an increase in competition that has forced them to pass most of their savings onto their customers. These factors have resulted in a lower profit margin for NR glove manufacturers.

Latex price assumption:

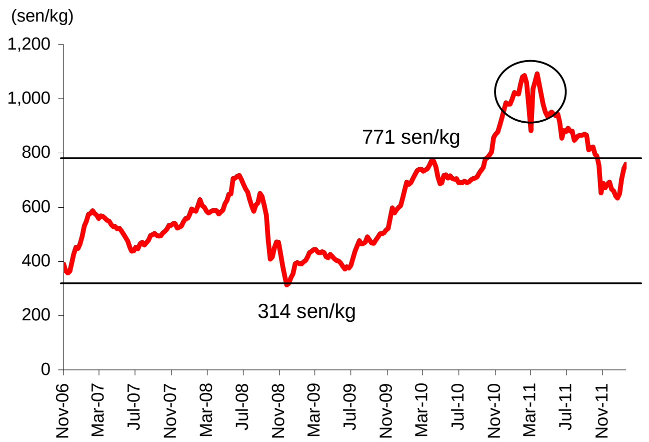
RM6.80-RM7.30/kg (2012-2013)

RM6.00-RM6.50/kg (2014-2015)

⇒ Since the beginning of the year, we have seen the natural rubber price recover from its low as we are entering the wintering season for rubber trees. We think that the latex price will continue to stay firm around the RM7/kg range for the year, as the Thai government has started to intervene in the Thai natural rubber latex market by offering Bt120/kg (RM11.84/kg) for locally-grown natural rubber.

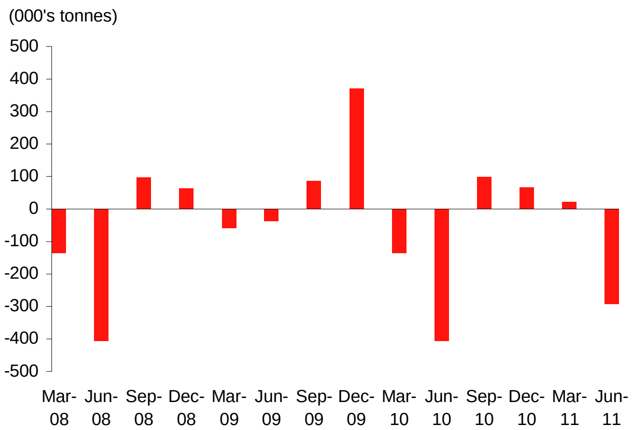
⇒ With the International Rubber Study Group (IRSG) forecasting a tight supply going through 2013, we believe that latex should be trading at the upper end of its trading band. Given the current market conditions, we expect latex to trade around RM6.80/kg–RM7.30/kg for 2012–13, and RM6.00/kg–RM6.50/kg for 2014–15.

Fig 16 Latex prices have started to correct



Source: Bloomberg, Macquarie Research, February 2012

Fig 17 A deficit going into the wintering season should drive latex price higher

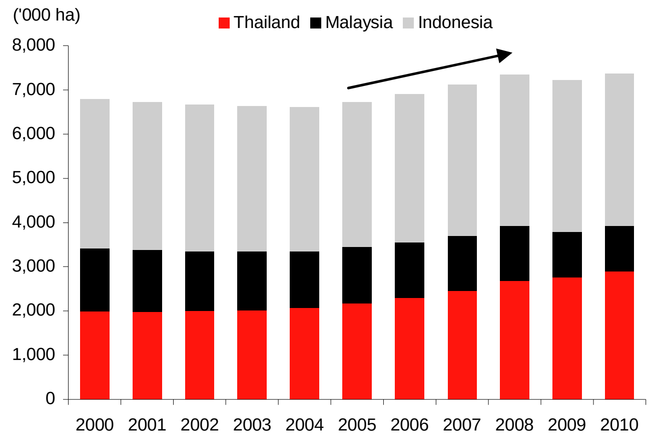


Source: Bloomberg, Macquarie Research, February 2012

⇒ Despite the tight NR supply, we do not foresee a shortage. Most of the glove manufacturers have contract agreements where pricing is based on average monthly pricing with plantation holders in Malaysia and Thailand. While they may not get the full benefit when prices start to fall, they will be able to secure enough latex for production during an uptrend.

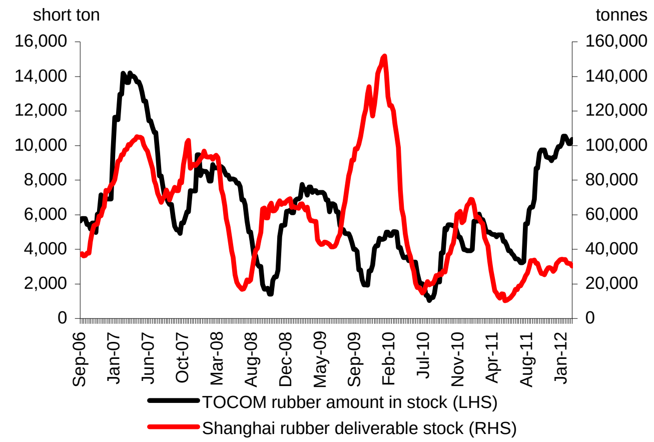
⇒ We do not believe that the recent floods in Thailand will have the same impact as the 2010 floods, as only the northern part of Thailand is affected. Most Thai rubber plantations are in the south of the country, which is not affected by the floods. However, we view this as a positive, as the auto manufacturing companies in northern Thailand were unable to take delivery of NR, thus easing the upward price pressure.

Fig 18 More latex supply is expected as most rubber tree were planted during 2005–08



Source: Bloomberg, Macquarie Research, February 2012

Fig 19 Increasing inventories show no short-term supply shortage concern



Source: Bloomberg, Macquarie Research, February 2012

- **Energy subsidies cut will have an impact, but it should be minimal.** In May 2011, the Malaysian government raised the electricity tariff by 7% and natural gas prices by 20%. The government stated that the tariffs would be revised every six months to move the selling prices of natural gas and electricity closer to the market prices. The impact of these hikes should be minimal for the glove manufacturers, as we estimate that a 20% increase in the natural gas price would only increase ASP by 0.3%.

Fig 20 Government's proposed rationalisation plan for natural gas

	Current Price	2012		2013		2014		2015	
	(RM/mmbtu)	June	Dec	June	Dec	June	Dec	June	Dec
Power Producer	13.70	19.70	22.70	25.70	28.70	31.70	34.70	37.70	40.70
Gas Malaysia	14.05	20.05	23.05	26.05	29.05	32.05	35.05	38.05	41.05
Industry > 2mmscfd	18.35	24.35	27.35	30.35	33.35	36.35	39.35	42.35	45.35

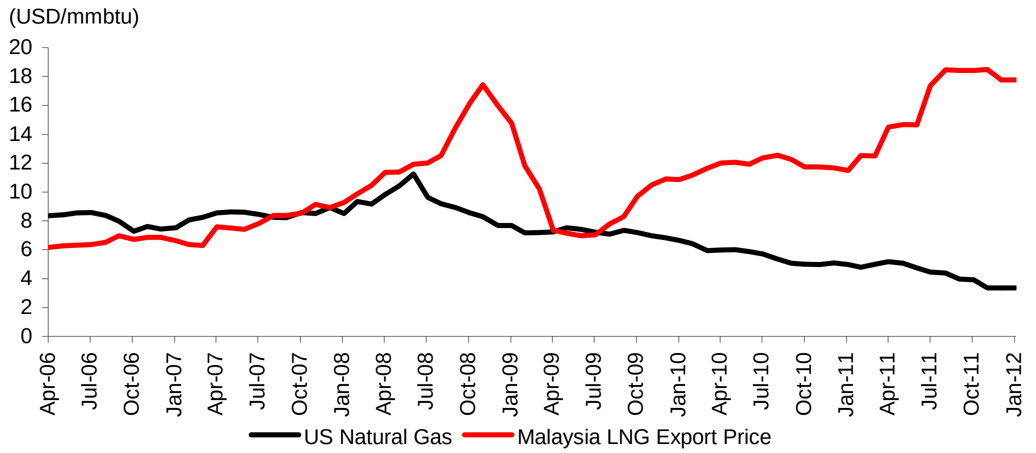
Source: PEMANDU, Macquarie Research, February 2012

No tariff revision for natural gas and electricity till next general election

⇒ Given that the international natural gas price is falling and there may be a general election in 2012–13, we think that the government will be reluctant to follow through with its plan to impose the fuel pass-through mechanism for the electricity tariff. As there was no price hike in December 2011, we think that the government is likely to postpone the plan until after the next general election.

⇒ The biggest concern for the Malaysian manufacturers is securing an adequate supply of natural gas. Malaysia has been facing gas shortages since 2007, but the government hopes to resolve these by the opening of an LNG regasification plant in Melaka by mid-2012. Manufacturers have also tried to mitigate some of this risk by installing biomass boilers, but we do not believe this is a suitable long-term solution as biomass boilers are less effective and less reliable than natural gas.

Fig 21 International natural gas price is trending down



Source: Bloomberg, Macquarie Research, February 2012

⇒ Even with the tariff increase, electricity is still relatively cheap in Malaysia. This gives the Malaysian manufacturers a slight advantage against most other rubber glove manufacturing countries. In terms of average electricity pricing, Malaysia is still cheaper than Thailand and China but a bit more expensive than Indonesia.

Fig 22 Electricity tariffs for Indonesia, Thailand, Malaysia and mainland China

Country	Electricity Tariff
Indonesia	• 3,500 VA -14 kVA : USD 9.15cent/kWh
Thailand	• 0-150 kwh : USD 5.93cent /kWh • 151-400kwh: USD 9.14cent /kWh • Over 400kwh : USD 9.79cent /kWh
Malaysia	• USD 9.46cent/kwh (High voltage peak) • USD 5.68cent/kwh (High voltage off-peak)
China	• USD 16.00cent/kWh on average

Source: Tenaga Malaysia, PT PLN, China State Power, Macquarie Research, February 2012

FX assumptions for 2012: USD/MYR: 3.0 USD/IDR: 8000 USD/THB: 29.0

- **Weak USD makes life difficult.** Rubber glove producers are naturally exposed to the volatility of the USD. Ninety percent of rubber gloves sold are quoted in USD, while most of the costs are in Malaysian Ringgit (MYR). The exception is nitrile gloves, for which synthetic/nitrile latex is transacted in USD. To mitigate currency risk, manufacturers frequently adjust their pricing to protect their margins. Moving forward, we expect the Malaysian manufacturers' margins to be lower due to the weakening of USD. We expect USD/MYR to reach 3.0 by the end of 4Q2012, while we forecast the USD/IDR and USD/THB to be at 8,000 and 29.0, respectively. Malaysian manufacturers should be in a better position than their Indonesian and Thai peers, as we do not expect the ringgit to move significantly this year.

Fig 23 We forecast MYR currency movements to be less volatile compared to other glove-producing countries in 2012

		Current	2Q2012E	3Q2012E	4Q2012E	4Q2013E	4Q2014E
USD/MYR		3.01	3.05	3.05	3.00	2.80	2.80
	vs current		**1%**	**1%**	**0%**	**-7%**	**-7%**
USD/THB		30.35	30.00	29.50	29.00	26.00	26.00
	vs current		**-1%**	**-3%**	**-4%**	**-14%**	**-14%**
USD/IDR		9,128	8,600	8,300	8,000	8,000	8,000
	vs current		**-6%**	**-9%**	**-12%**	**-12%**	**-12%**

Prices as of 28 February 2012

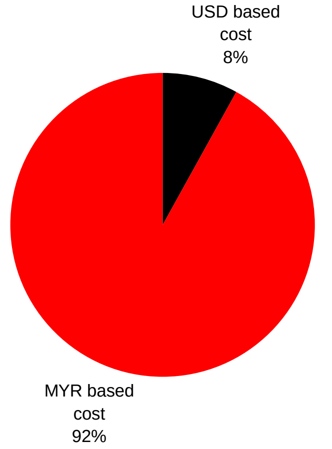
Source: Company data, Macquarie Research, February 2012

Nitrilization is no industry saviour

Most of the planned additional capacity for 2012 is focused on flexible interchangeable lines for nitrile and natural rubber glove production, and we view this as positive:

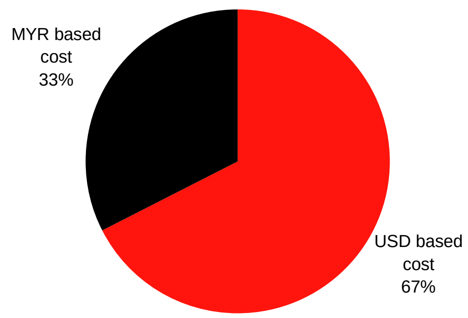
- **Stabilizing margin, as nitrile glove pricing correlates to the USD.** Switching from natural rubber (NR) to nitrile rubber will help decrease the earnings sensitivity to the USD. We expect the switch will decrease the USD exposure from over 56% to 46%, as nitrile rubbers are traded in USD. The decrease in exposure should be beneficial for Malaysian manufacturers, as we forecast further strengthening of the Malaysia Ringgit against the US Dollar. The switch will help Malaysian manufacturers to be more competitive in pricing and quality, rather than losing market share due to unfavourable currency movements.

Fig 24 Natural rubber gloves have higher exposure to MYR-based costs



Source: Supermax, Macquarie Research, February 2012

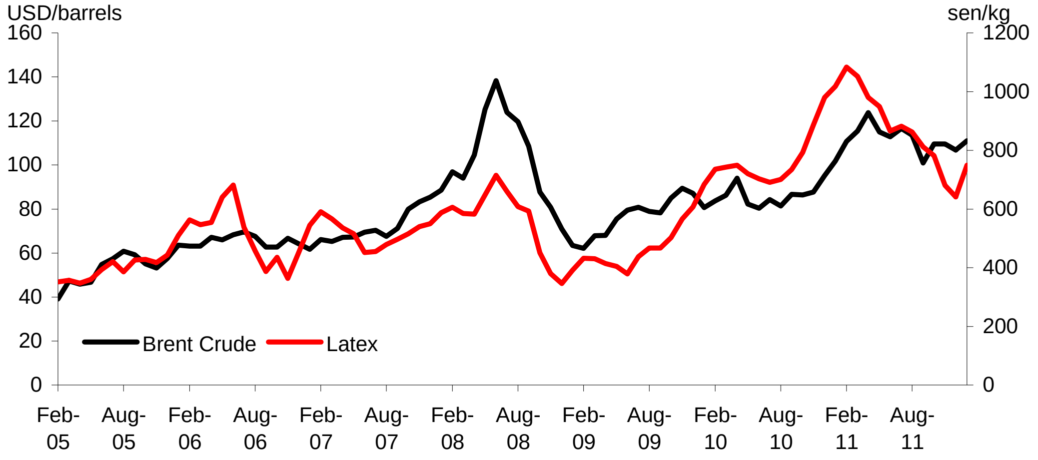
Fig 25 Nitrile rubber gloves have higher exposure to USD based costs



Source: Supermax, Macquarie Research, February 2012

- **Nitrile rubber prices are not directly subject to speculative activity.** Butadiene, the main feedstock for nitrile rubber, is a by-product of the petrochemical chain and is not traded on any exchange. On the other hand, natural rubber, which is traded on several exchanges around the region, is subject to speculation, due to its use in the automotive industry. Manufacturers also benefit from the pricing structure of nitrile rubber, as the prices are quoted before delivery, whereas the pricing for natural rubber is determined by the monthly average of the previous month. Manufacturers will be able to pass on any increase in nitrile rubber cost more effectively, as they are less frequent and less volatile than NR cost changes.

Fig 26 Latex correlation has deviated from crude oil price



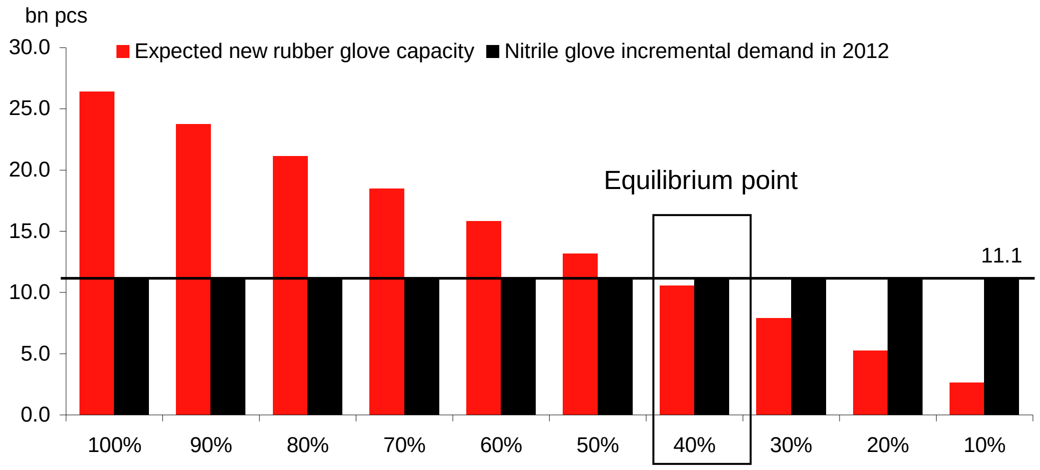
Source: Bloomberg, Macquarie Research, February 2012

- **Increase in demand from developed markets.** Latex allergy is an issue for healthcare professionals. Powder-free gloves are able to reduce, rather than eliminate, the risk of allergy. Nitrile gloves are a good substitute, and used to be at least 15–20% more expensive than powder-free gloves. However, due to the recent rise in natural rubber prices, the premium has fallen to 5–10%. This has started to prompt the switch to nitrile gloves in developed countries. We believe that this will help to compensate for some of the fall in powder-free rubber glove orders, while maintaining manufacturers' production scale.

But we expect overcapacity in nitrile glove segment in 2012 too

As most of the installed capacity by rubber glove manufacturers in 2012 will be focusing on the production of nitrile gloves, we are expecting overcapacity to be an issue in this segment too. We forecast demand for nitrile gloves to grow by 11.1bn pieces in 2012.

Fig 27 More than 40% of new capacity is for nitrile gloves, meaning that market will also face overcapacity



Source: Macquarie Research, February 2012

In summary, we think that nitrile gloves will not be a life-saver for the glove manufacturers, as overcapacity is likely to remain a medium-term issue. We expect some consolidation within the industry in the next two to three years, as industry players will need to consolidate excess capacity to improve their profit margins.

Expensive valuations across the sector

Fig 28 Malaysia rubber glove company coverage

Code	Company	Price (RM)	Mkt Cap (RM m)	PE (x)	FY12 EPS Growth (%)	FY13 EPS Growth (%)	FY05-FY10 EPS Growth (%)	PB(x)	ROE (%)	Yield (%)	ADT (US$m)
TOPG MK	Top Glove	4.90	3,031	20.0	33.9	8.5	35.7	2.5	13.1	3.0	1.45
HART MK	Hartalega	8.36	3,048	15.1	6.0	8.7	40.0	5.0	36.8	3.3	0.58
SUCB MK	Supermax	1.93	1,313	11.0	12.9	9.4	36.0	1.5	14.8	2.7	2.14
Sub-sector			**7,337**	**15.7**						**2.7**	**4.17**

* Hartalega FY05-FY10 EPS growth is from FY08-FY11

Source: Bloomberg, Macquarie Research, February 2012; 28 Feb pricing

As shown in Fig 28, we do not think the stocks' historical PER is a valid valuation method, as the industry no longer provides the same growth profile that was its catalyst. We are using premium/discount to the industry historical PER valuation method to value the companies we cover, as they manufacture a semi-commoditized product and therefore should be valued based on their market leadership relative to the industry. A summary table of our recommendations and target prices vs Bloomberg consensus is shown in below.

Fig 29 Target price and recommendation vs consensus

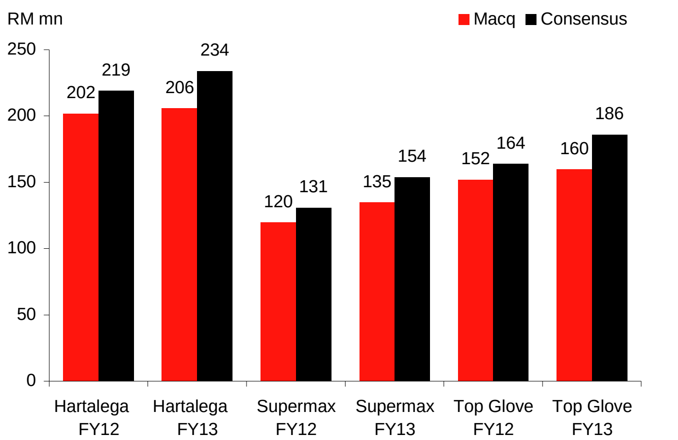
(RM)	Top Glove (TOPG MK)	Supermax (SUCB MK)	Hartalega (HART MK)
Recommendation	**UP**	**UP**	**UP**
Macquarie target price	4.10	1.48	7.20
Current price	4.90	1.93	8.36
Up/downside to Macq TP (%)	-16.3	-23.3	-13.9
Target price comparison			
Consensus target price	4.67	2.00	8.22
Up/downside (%)	-4.7	3.6	-1.7
Macquarie vs consensus (%)	-12.2	-26.0	-12.4
Consensus recommendations			
Buy	8	6	10
Hold	4	6	2
Sell	10	1	0
Total	**22**	**13**	**12**

Share prices as of: 28 February 2012

Source: Bloomberg, Macquarie Research, February 2012

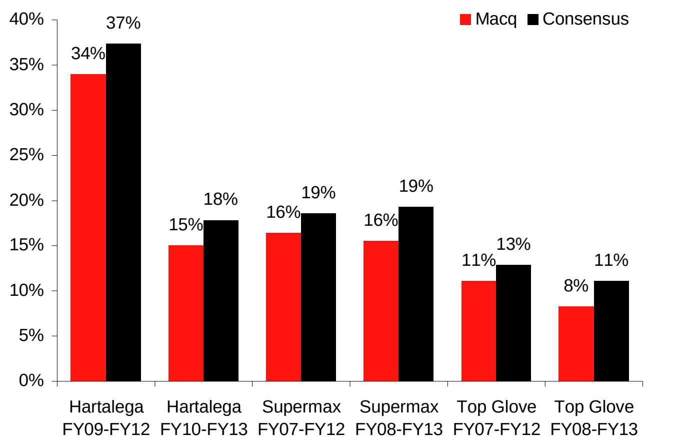
We think that the market has yet to factor in an oversupply scenario, as consensus has been overly optimistic on the margin recovery story through increasing production of higher-margin nitrile gloves. Most of the consensus estimates have yet to factor in the impending overcapacity issue in the nitrile gloves segment, which we believe will act as a catalyst to derate the sector.

Fig 30 Consensus would have to downgrade net profit estimates



Source: Bloomberg, Macquarie Research, February 2012

Fig 31 Overly optimistic consensus earnings growth projections

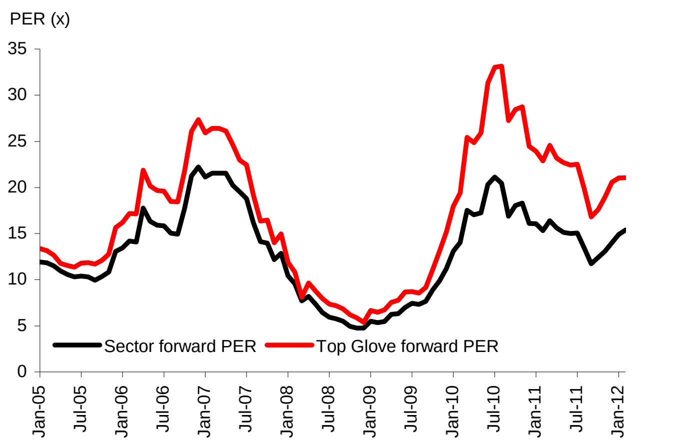


Source: Bloomberg, Macquarie Research, February 2012

Top Glove and Hartalega are trading above sector five-year historical 13x forward PER average; Supermax continues to trade at a discount

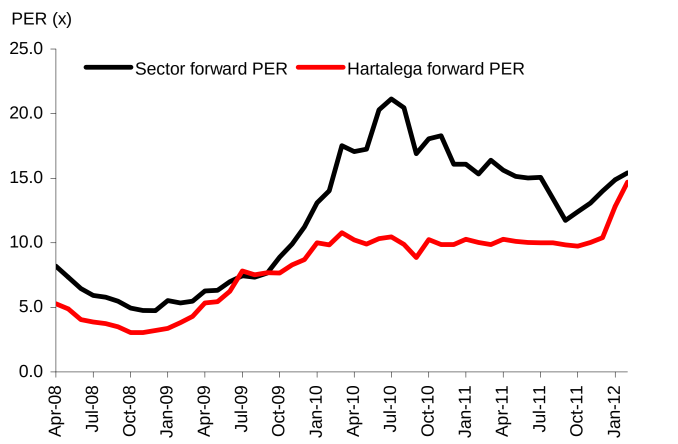
As shown in the forward PER chart in Fig 36, there is a positive relationship between the sector PER and market share. Industry leader Top Glove is trading at a premium, while Hartalega and Supermax are trading close to the industry average.

Fig 32 Top Glove trades at a premium to the sector due to its market leadership



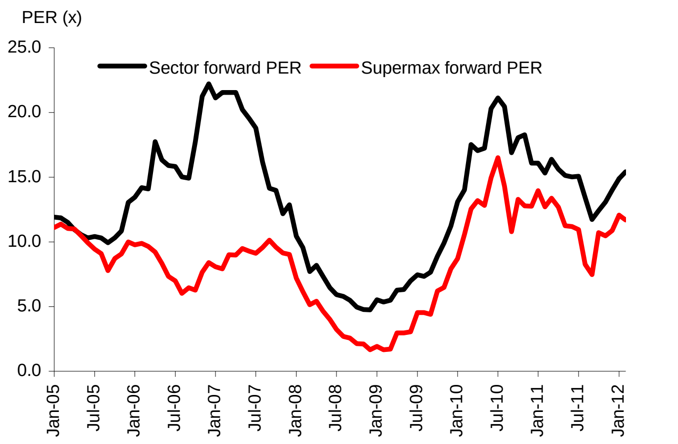
Source: Bloomberg, Macquarie Research, February 2012

Fig 33 Hartalega is heading for a slight premium



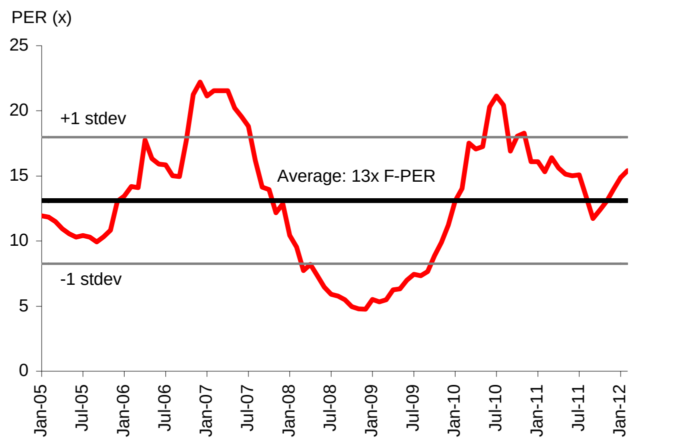
Source: Bloomberg, Macquarie Research, February 2012

Fig 34 Supermax trades at a discount to the sector



Source: Bloomberg, Macquarie Research, February 2012

Fig 35 Sector forward PER is trading within 1 standard deviation

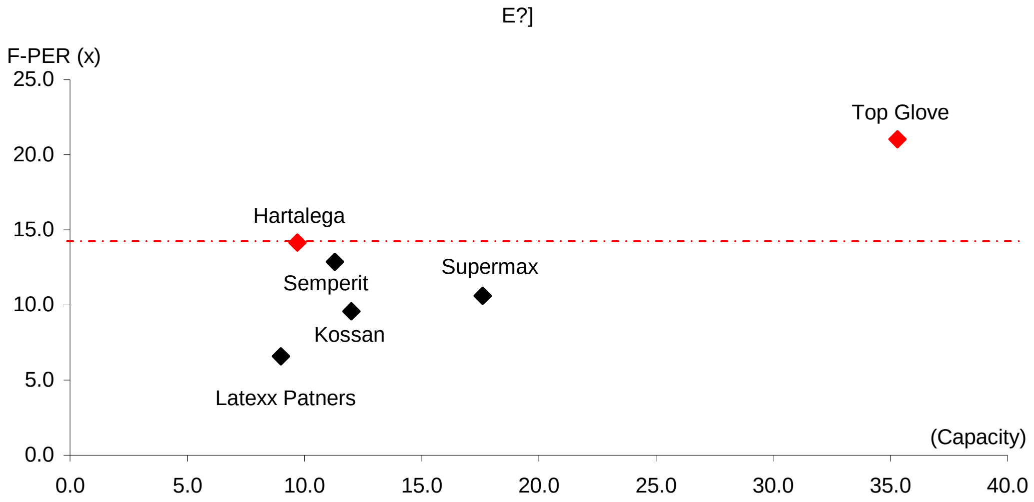


Source: Bloomberg, Macquarie Research, February 2012

It is clear to us that the market favours industry leaders in this semi-commoditized product industry, as the leaders are usually price-setters. Despite a looming price war, we believe our Top Glove and Hartalega valuations are sustainable, as price-setters have better margin control than price-takers.

Some might argue that Hartalega was trading below the sector since its listing before the recent rally, but we think the stock deserves to trade close to the sector average, as it has transformed itself into the world's largest nitrile glove manufacturer.

Fig 36 Premium valuation for market leaders – FY12E PER

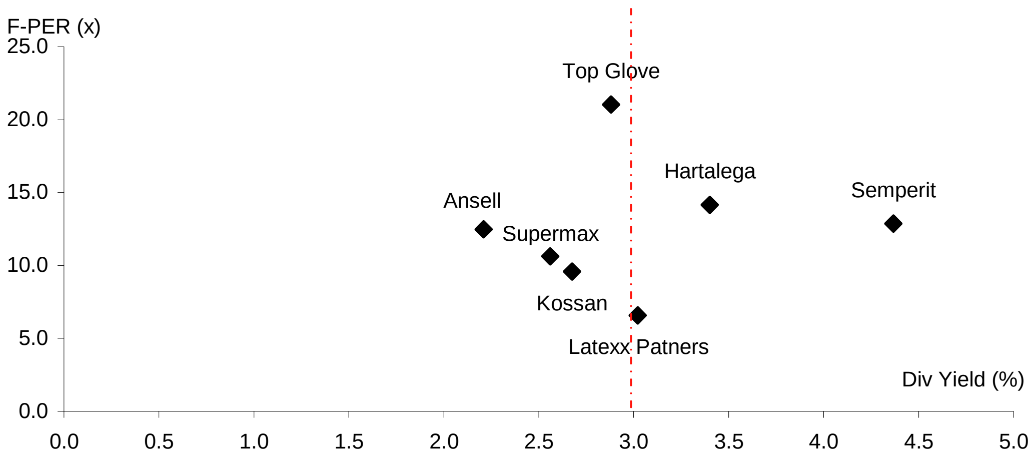


Source: Bloomberg est. for nonrated stocks, Macquarie Research, February 2012

Average 3% dividend yield across the sector

Although Top Glove and Hartalega are trading at a premium to their peers, they are still offering close to the forecast industry average dividend yield of 3% for FY12. Hartalega and Top Glove have an official payout policy of 50% and 40%, respectively, while Supermax has a payout policy of 30%. Although glove companies have significant capex requirements, we believe they have relatively stable cash flow and stable demand, and thus are able to pay out dividends like other defensive consumer stocks.

Fig 37 Glove stocks on average are offering 3% yield for FY12E

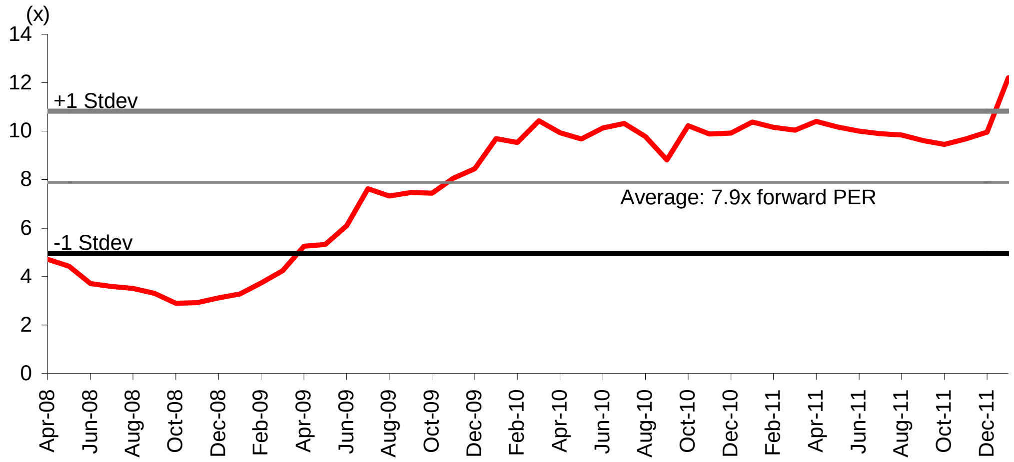


Source: Bloomberg est. for nonrated stocks, Macquarie Research, February 2012

Historical PER does not give a clear picture

We have an Underperform recommendation on Top Glove, Hartalega and Supermax, but only Hartalega is currently trading 1 standard deviation above its historical average PER.

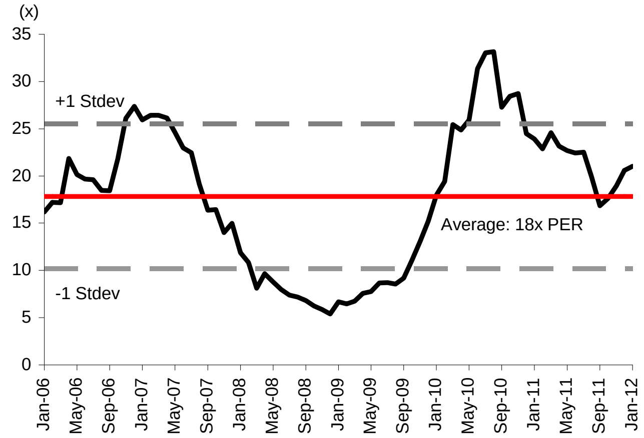
Fig 38 Hartalega PE band chart doesn't reflect the new business model



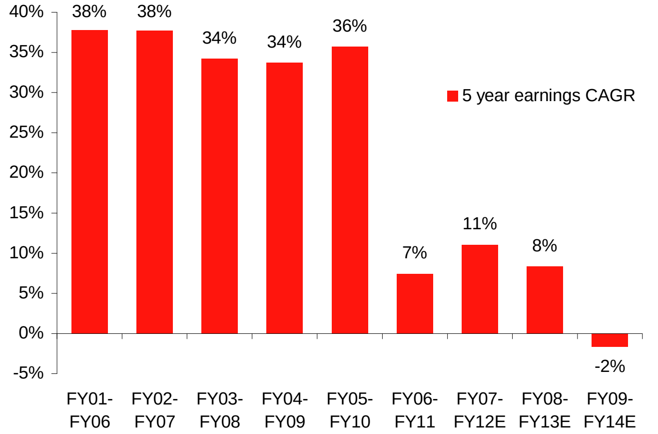
Source: Bloomberg, Macquarie Research, February 2012

We do not think Hartalega will trade back to its historical average, as the company has evolved into a high-margin nitrile glove manufacturer with a clear strategy to maintain its position in this profitable segment. We value the company at 13x forward PER, at the sector historical PER, as it has established itself as the world's largest nitrile glove manufacturer, as we think Hartalega will need to prove to the market that it has the ability to overcome the competition and hold on to its premium valuation.

Fig 39 Top Glove's historical PER valuation does not reflect the company's lack of future growth prospects



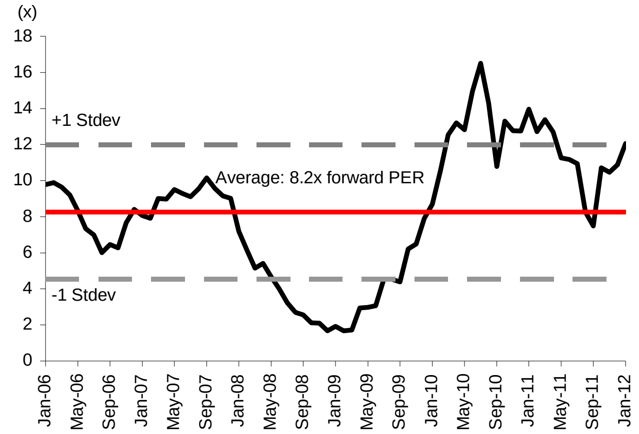
Source: Bloomberg, Macquarie Research, February 2012



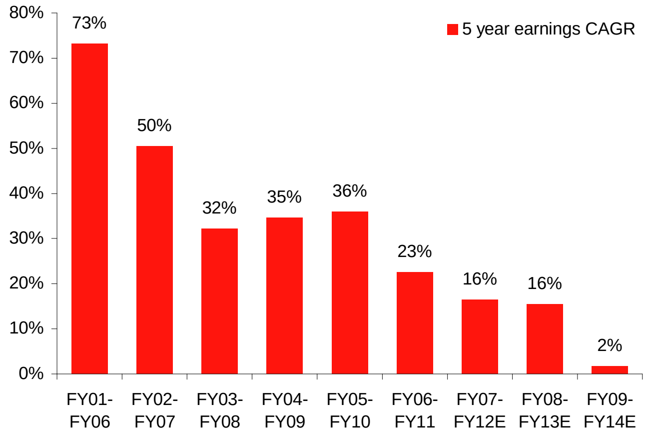
Source: Bloomberg, Macquarie Research, February 2012

Although Top Glove is trading within its 1 standard deviation band, we think it is expensive. We expect growth to slow as competition intensifies when the manufacturers' new capacity comes online in 2H12. The stock is currently trading at 20x FY12E PER and we value it at a 25% premium to the industry at 16.7x PER.

Fig 40 Supermax's historical PER valuation does not reflect its lack of future growth prospects



Source: Bloomberg, Macquarie Research, February 2012



Source: Bloomberg, Macquarie Research, February 2012

We also have an Underperform recommendation on Supermax, despite it trading within the 1 standard deviation band. We value to the stock based on a 35% discount to the sector historical PER at 8.4x, as the company has failed to create a sustainable market niche for itself, in our view. We think Supermax will be at a disadvantage when competition intensifies, as it is primarily a price-taker.

MALAYSIA

TOPG MK Underperform

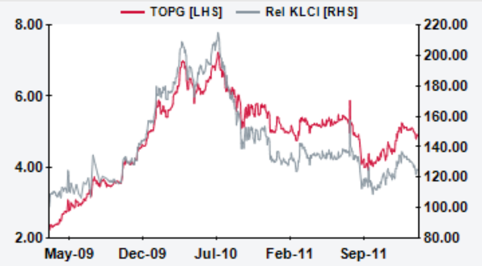
Close Price* 28 Feb 12 RM4.90

12-month target	**RM**	**4.11**
Upside/Downside	**%**	**-16.1**
Valuation	**RM**	**4.11**
- PER		
GICS sector		
Health Care Equipment & Services		
Market cap	**RMm**	**3,031**
30-day avg turnover	**US$m**	**1.4**
Market cap	**US$m**	**1,002**
Number shares on issue	**m**	**618.6**

Investment fundamentals

Year end 31 Aug		2011A	2012E	2013E	2014E
Revenue	m	2,053.9	2,230.1	2,519.2	2,698.1
EBIT	m	144.7	194.3	210.4	198.3
EBIT growth	%	-52.8	34.3	8.3	-5.8
Reported profit	m	113.1	151.5	164.4	155.5
Adjusted profit	m	113.1	151.5	164.4	155.5
EPS rep	sen	18.3	24.5	26.6	25.2
EPS rep growth	%	-54.9	33.9	8.5	-5.4
EPS adj	sen	18.3	24.5	26.6	25.2
EPS adj growth	%	-55.0	33.9	8.5	-5.4
PER rep	x	26.8	20.0	18.4	19.5
PER adj	x	26.8	20.0	18.4	19.5
Total DPS	sen	11.0	14.7	16.0	15.1
Total div yield	%	2.2	3.0	3.3	3.1
ROA	%	10.5	13.3	13.4	12.0
ROE	%	10.2	13.1	13.4	12.1
EV/EBITDA	x	13.6	10.8	10.1	10.4
Net debt/equity	%	-12.8	-19.3	-20.1	-20.4
P/BV	x	2.7	2.5	2.4	2.3

TOPG MK rel KLCI performance



Source: FactSet, Macquarie Research, March 2012
(all figures in MYR unless noted)

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1 March 2012
Macquarie Capital Securities (Malaysia) Sdn. Bhd.

Top Glove

Defending champ taking a hit

Event

- We are initiating coverage of Top Glove, the world's largest rubber glove manufacturer, with an Underperform recommendation and target price of RM4.11, giving 16% potential downside from the current price. We believe 2012 will be a challenging year for Top Glove, as we are expecting overcapacity and potential delays in the company's expansion plan to slow margin recovery and profit growth.

Impact

- **Net profit margins to improve to 7% in 2012E but still remain below historical average of 10%.** As we are expecting competition to intensify in 2012, we believe industry supply of rubber gloves will outpace demand. In order to maintain market share and utilization of 70%, we expect Top Glove to sacrifice margin in favour of volume growth. Nevertheless, we expect revenue for FY12 and FY13 to grow 9% and 13%, respectively.
- **Diversifying into synthetic gloves helps, but not for long.** Top Glove has started installing new interchangeable production lines to produce higher-margin nitrile gloves. Top Glove expects its percentage of nitrile gloves to reach 50% of total production by 2015. While nitrile gloves garner a higher margin, we believe the overall oversupply situation will still cap the selling price.
- **More delays of expansion plan, with minimal impact.** Despite running at an undemanding 70% utilization rate, Top Glove is still committed to expanding its current capacity 20% to 43bn pieces by end-2012. Although deferring some expansion plans may increase the utilization rate, it also may hamper the company's ability to ramp up production should a pandemic occur.

Earnings and target price revision

- Establishing FY12 and FY13 EPS estimates of 24.5sen and 26.6sen, respectively. Based on our target price of RM4.11, FY12E and FY13E implied PERs would be 16.8x and 15.5x, respectively.

Price catalyst

- 12-month price target: RM4.11 based on a PER methodology.
- Catalyst: Further delay in the company's expansion plan and an increase in the natural rubber price would keep margins under pressure.

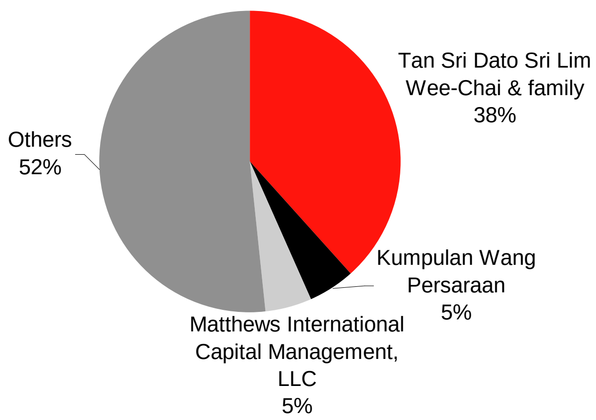
Action and recommendation

- We think the stock is overvalued, trading at 20x FY12E PER (vs the historical average of 18x). With our estimate of net profit growth at 13% per annum for the next three years, compared with historical growth of 29% per annum for the last ten years, we believe this supports a weaker outlook for Top Glove – hence our Underperform recommendation.
- For our sector views/themes, please see our initiation report, *Malaysia rubber gloves - Overcapacity remains an issue*, 29 February 2012.

Company profile

Started in 1991 and listed on Bursa Malaysia in March 2001, Top Glove has grown into the world's largest rubber glove manufacturer, with 22 factories in Malaysia, Thailand and China. Top Glove's current production capacity is more than 35bn pieces pa, while capturing 26% of the world rubber glove market share.

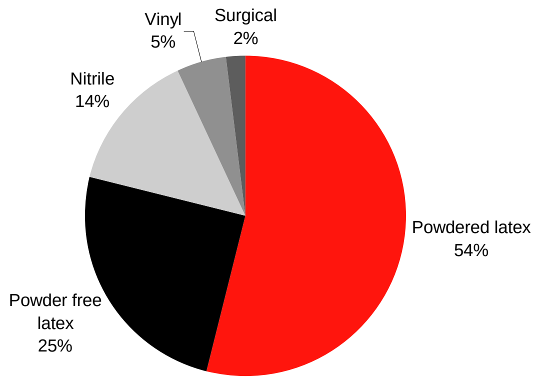
Fig 1 Top Glove's shareholding structure (as of 31 Oct 2011)



Source: Company data, Macquarie Research, March 2012

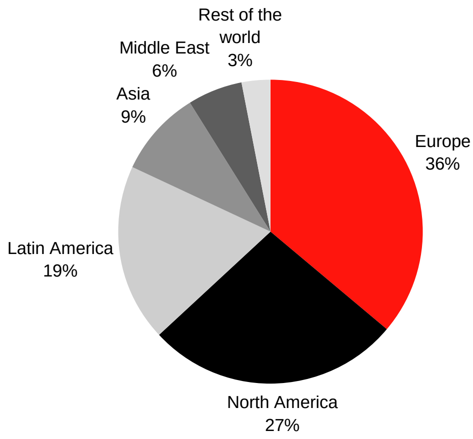
The company also has two latex concentration plants in Thailand, which source for latex supply, and a vinyl glove plant in China. Top Glove's products are mainly sold to distributors in developed countries.

Fig 2 1Q FY12 production breakdown, by type



Source: Company data, Macquarie Research, March 2012

Fig 3 1Q FY12 sales breakdown, by region

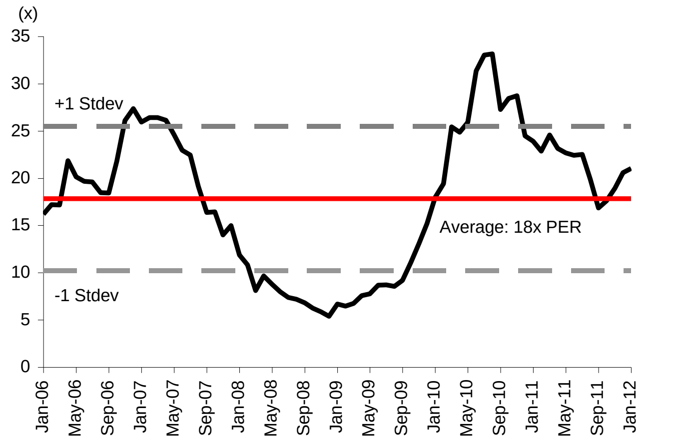


Source: Company data, Macquarie Research, March 2012

Top Glove founder, Tan Sri Dato Sri Lim Wee Chai, currently serves as chairman, while day-to-day operations are currently helmed by the company's managing director, Mr. Lee Kim Meow. Mr. Lee has been in this industry since 1997 and was appointed as managing director of Top Glove in 2009. Mr. Lee also sits on the board of the Malaysia Rubber Export Promotion Council (MREPC) and the Malaysian Rubber Board (MRB).

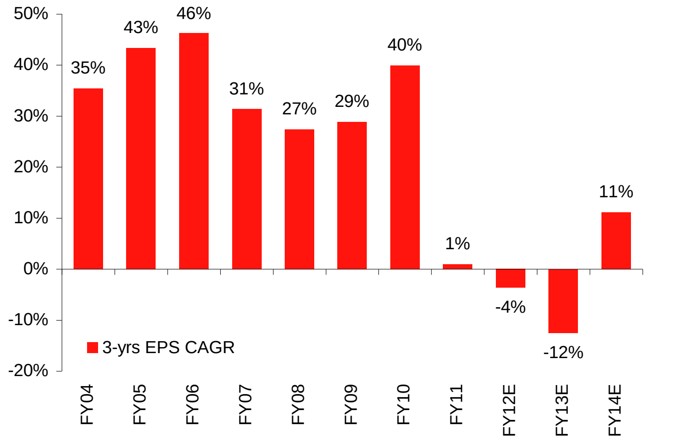
Rich valuation not supported by growth; target price: RM4.11

Fig 4 Top Glove shares trading above their historical PER average of 18x …



Source: Bloomberg, Macquarie Research, March 2012

Fig 5 … but look overvalued, as we are expecting to see slower profit growth

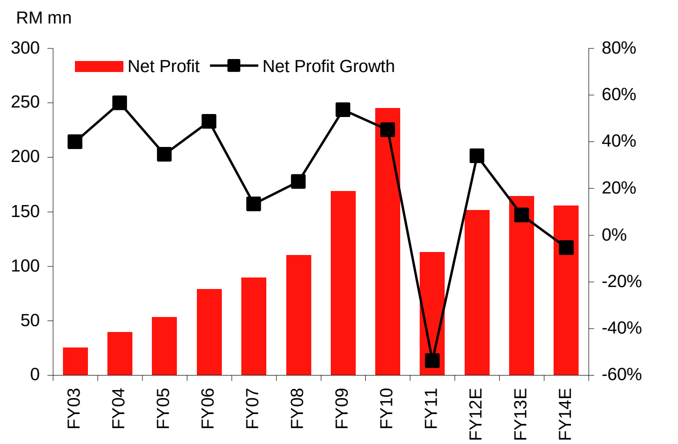


Source: Company data, Macquarie Research, March 2012

We value the stock based on a 28% premium to the five-year average of the industry forward PER instead of the stock's historical forward PER, because

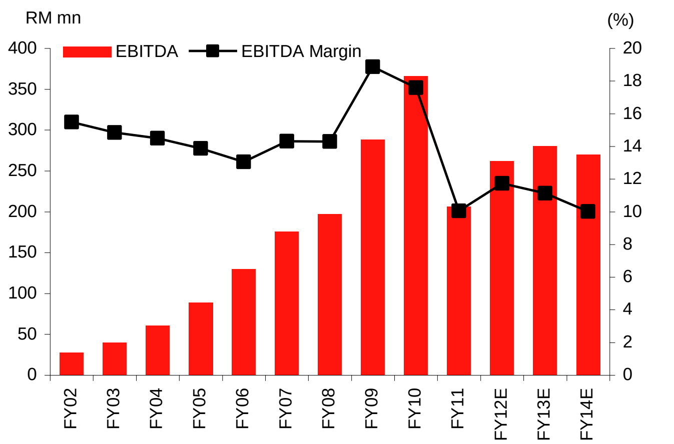
⇒ **Top Glove is growing at a slower pace.** Despite forecasting 34% net profit growth for FY12, we do not think the stock deserves to trade at its historical PER, as we are expecting profit growth to slow. As we show in Fig 6, net profit growth was on a declining trend from FY01–FY10, with a nine-year GAGR of 36%, compared with FY11–FY14, which saw a three-year CAGR of 11%.

Fig 6 Net profit growth is on a declining trend



Source: Company data, Macquarie Research, March 2012

Fig 7 EBITDA margin is on a declining trend, too

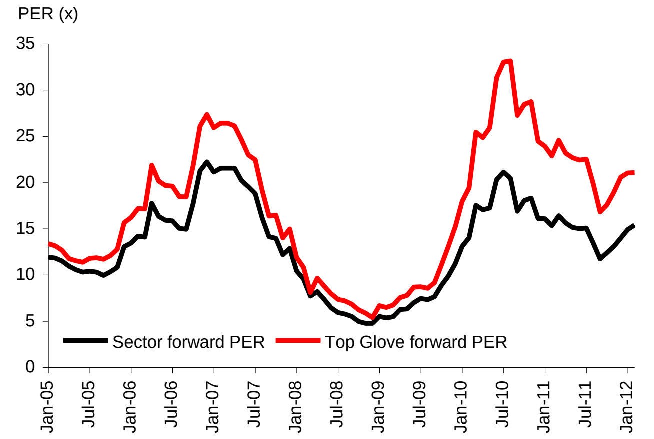


Source: Company data, Macquarie Research, March 2012

⇒ **Lower EBITDA margin.** We are forecasting slight EBITDA margin recovery to 12% in FY12 from 10% in FY11; however, we do not think the 12% margin is sustainable as we expect competition to set in and utilization rates to fall to 70%. We believe that most of the industry players, including Top Glove, will have to cut prices to maintain market share, as the industry is flooded with high unutilized capacity. We also do not foresee margin recovery beyond the company's historical norm of 14%. In Fig 7 we show our expectation for a declining EBITDA margin trend post FY12, ie, we believe that Top Glove will no longer be as profitable as it used to be.

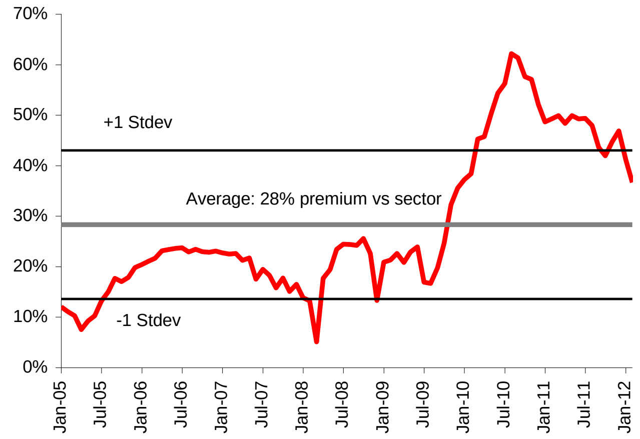
But Top Glove shares should continue to trade at a premium to the sector

Fig 8 Top Glove shares continue to trade above the sector



Source: Bloomberg, Macquarie Research, March 2012

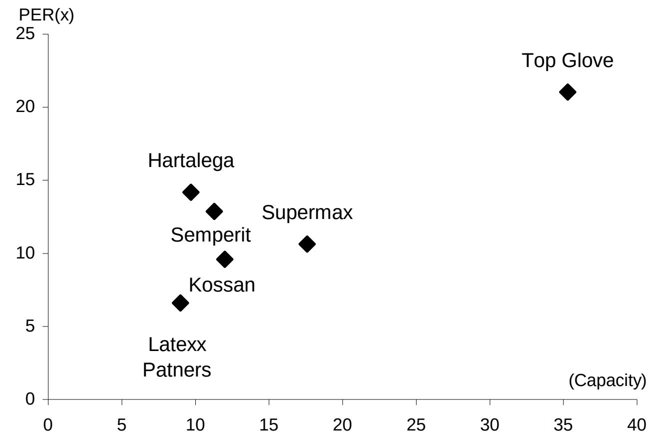
Fig 9 On average Top Glove shares trade at a 28% premium to the sector forward PER



Source: Bloomberg, Macquarie Research, March 2012

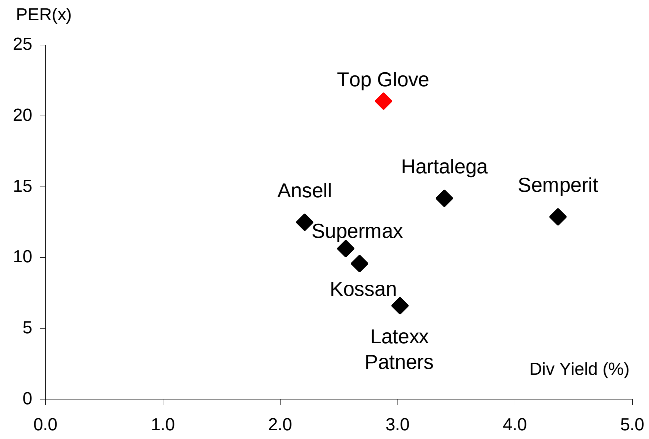
⇒ **Premium valuation for the industry leader.** As the largest rubber glove manufacturer, we believe that Top Glove deserves to trade at a premium to its peers. As we point out in our sector report, market leaders are able to command a premium due to their large installed capacity, which can influence the market selling price. Top Glove's closest competitor, Supermax, only has an installed capacity of 17bn pieces per annum, which is half Top Glove's current capacity of 35 bn pieces.

Fig 10 Premium valuation for industry leaders



Source: Bloomberg, Macquarie Research, March 2012

Fig 11 Dividend yield is on par with other players in the sector



Source: Bloomberg, Macquarie Research, March 2012

⇒ **Dividend yield on par with others.** Top Glove's current dividend yield of 3.0% is in line with the industry average of 3%, which also helps support its premium valuation. Top Glove has been paying dividends at a payout ratio of 40% of its earnings since FY09. Despite having a difficult year in FY11, Top Glove has increased its payout ratio to 60% to maintain its DPS payment to shareholders. Going forward we expect these dividend payments will be sustainable due to the nature of the business. We currently estimate FY12 and FY13 DPS of 14.7sen and 16.0sen (div yield FY12E: 3.0% and FY13E: 3.3%), respectively.

Is consensus overly optimistic? Our net profit number for FY12 is ~4% below the street's. We think consensus is overly optimistic about the recovery story and is not taking into account the oversupply issue in the nitrile segment by 2H12 that we foresee. The street is currently expecting net profit to grow by 15% every quarter in FY12 vs the average historical growth rate of 8.5%. We think the consensus growth rate is relatively high, as we believe the industry is heading into a price war.

Fig 12 Consensus likely underestimating the impact of overcapacity issue

(RM m)	Macquarie	Consensus	Diff
Net profit (FY12)	151	158	-3.8%
Net profit (FY13)	164	184	-10.9%
Net profit (FY14)	155	203	-23.5%
EBITDA (FY12)	262	263	-0.3%
EBITDA (FY13)	280	301	-6.9%
EBITDA (FY14)	270	347	-22.3%

Source: Bloomberg, Macquarie Research, March 2012

Downside risk to our valuation would be a worse-than-expected price war and further delay in expansion plans, which would impact the company's ability to compete should a pandemic occur.

Business model intact, but margins slipping away

- **Margin improvement in 1Q12E,** but we think that it is too early to make a conclusion that the company is back on the right track, and we are expecting the EBITDA margin to stay within a 10–12% range for the next two years – still below the historical 13–19% range. We think the margin will continue to slide, as we are predicting a price war in 2H12. We also think that an EBITDA margin between 12% and 13% would only be achievable with the phasing out of the company's old, inefficient line.
- **Delay in expansion plans, again.** Despite delays to the company's original expansion plan, we think that the short-term impact on profit should be minimal. Based on the current undemanding 70% utilization rate, Top Glove still has extra capacity through which it could monetize any demand spike in the market. However, we view the expansion plan delay positively in the short term, as more capacity in the system would only worsen the overcapacity situation, but remain cautious on the delay longer term, as we think it will hamper the company's ability to capture market share.

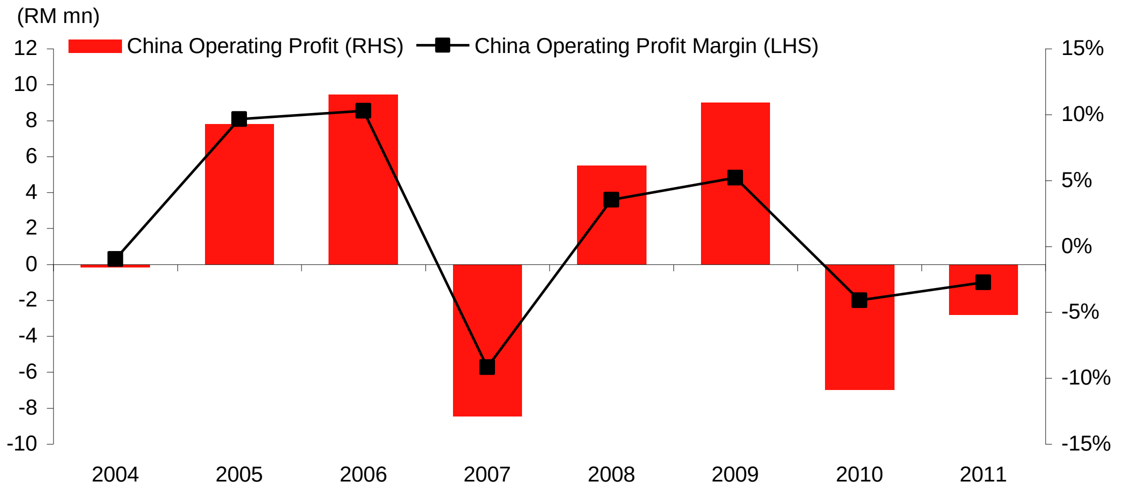
Fig 13 Production capacity expansion plan

Factory	Location	No. of additional lines	Capacity p.a.	Revised Target completion	Original Plan
Factory 22	Klang, Malaysia	14	1.3 bn pcs	Feb – 2012	1.5 bn pcs (Mar - 2011)
Factory 23					
Phase 1	Ipoh, Malaysia	16	1.4 bn pcs	Feb - 2012	3.0 bn pcs (May - 2011)
Phase 2	Ipoh, Malaysia	16	1.5 bn pcs	Aug - 2012	
Factory 24	Klang, Malaysia	16	1.5 bn pcs	Aug - 2012	New
	Total	**62**	**5.7 bn pcs**		

Source: Company data, March 2012

- **Diversifying into nitrile glove slows margin erosion.** Top Glove has been actively installing interchangeable product lines in its new facilities. We view this move as positive given an increasing preference for nitrile gloves and as a switch from natural rubber to nitrile could help ease margin compression pressure in the natural rubber segment. Despite our forecast for an oversupply issue in both the nitrile and natural rubber glove segments, we believe that nitrile gloves will continue to have a slightly better margin than natural rubber gloves.
- **China venture operations still in the red.** Top Glove ventured into China in 2002, and results over the years have not been impressive. Due to the lack of economies of scale in Top Glove China's PE and vinyl glove operations, the company has been unable to compete with Chinese manufacturers in the local market.
- Top Glove has plans to venture into the distribution business in China and is looking for an import license to help facilitate the importation of rubber gloves into China for Chinese distributors. We view this move as positive for Top Glove long term, as we believe China is poised to become the fastest-growing market for gloves, with usage still low compared with developed countries.

Fig 14 China venture is loss-making but should not be a drag on Top Glove earnings



Source: Company data, Macquarie Research, March 2012

Top Glove (TOPG MK, Underperform, Target Price: RM4.11)

Quarterly Results		1Q/12A	2Q/12E	3Q/12E	4Q/12E
Revenue	**m**	**555**	**534**	**571**	**570**
Gross Profit	**m**	**100**	**103**	**110**	**110**
Cost of Goods Sold	m	455	431	461	460
EBITDA	**m**	**59**	**63**	**70**	**70**
Depreciation	m	17	17	17	17
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**42**	**46**	**53**	**53**
Net Interest Income	m	-0	0	0	0
Associates	m	-0	-0	-0	-0
Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	0	0	0	0
Pre-Tax Profit	**m**	**42**	**46**	**53**	**53**
Tax Expense	m	-9	-9	-10	-10
Net Profit	**m**	**32**	**37**	**43**	**43**
Minority Interests	m	-1	-1	-1	-1
Reported Earnings	**m**	**31**	**36**	**42**	**42**
Adjusted Earnings	**m**	**31**	**36**	**42**	**42**
EPS (rep)	sen	5.1	5.9	6.8	6.8
EPS (adj)	sen	5.1	5.9	6.8	6.8
EPS Growth yoy (adj)	%	-12.9	43.7	63.4	60.2
EBITDA Margin	%	10.5	11.9	12.2	12.3
EBIT Margin	%	7.5	8.7	9.3	9.3
Earnings Split	%	20.7	24.1	27.6	27.6
Revenue Growth	%	12.9	10.1	6.7	5.2
EBIT Growth	%	-6.0	49.0	54.4	52.5

Profit & Loss		2011A	2012E	2013E	2014E
Revenue	**m**	**2,054**	**2,230**	**2,519**	**2,698**
Gross Profit	**m**	**315**	**423**	**473**	**490**
Cost of Goods Sold	m	1,739	1,807	2,047	2,208
EBITDA	**m**	**206**	**262**	**280**	**270**
Depreciation	m	62	67	70	72
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**145**	**194**	**210**	**198**
Net Interest Income	m	-0	-0	0	0
Associates	m	1	-0	-0	-0
Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	0	0	0	0
Pre-Tax Profit	**m**	**145**	**194**	**210**	**198**
Tax Expense	m	-30	-39	-42	-40
Net Profit	**m**	**115**	**155**	**168**	**159**
Minority Interests	m	-2	-4	-4	-3
Reported Earnings	**m**	**113**	**151**	**164**	**155**
Adjusted Earnings	**m**	**113**	**151**	**164**	**155**
EPS (rep)	sen	18.3	24.5	26.6	25.2
EPS (adj)	sen	18.3	24.5	26.6	25.2
EPS Growth (adj)	%	-55.0	33.9	8.5	-5.4
PE (rep)	x	26.8	20.0	18.4	19.5
PE (adj)	x	26.8	20.0	18.4	19.5
Total DPS	sen	11.0	14.7	16.0	15.1
Total Div Yield	%	2.2	3.0	3.3	3.1
Weighted Average Shares	m	618	618	618	618
Period End Shares	m	618	618	618	618

Profit and Loss Ratios		2011A	2012E	2013E	2014E
Revenue Growth	%	-1.2	8.6	13.0	7.1
EBITDA Growth	%	-43.6	26.9	7.0	-3.6
EBIT Growth	%	-52.8	34.3	8.3	-5.8
Gross Profit Margin	%	15.4	19.0	18.8	18.2
EBITDA Margin	%	10.0	11.7	11.1	10.0
EBIT Margin	%	7.0	8.7	8.4	7.3
Net Profit Margin	%	5.6	7.0	6.7	5.9
Payout Ratio	%	60.1	60.0	60.0	60.0
EV/EBITDA	x	13.6	10.8	10.1	10.4
EV/EBIT	x	19.4	14.5	13.4	14.2
Balance Sheet Ratios					
ROE	%	10.2	13.1	13.4	12.1
ROA	%	10.5	13.3	13.4	12.0
ROIC	%	13.4	15.5	17.2	15.5
Net Debt/Equity	%	-12.8	-19.3	-20.1	-20.4
Interest Cover	x	598.0	6,939.2	nmf	nmf
Price/Book	x	2.7	2.5	2.4	2.3
Book Value per Share		1.8	1.9	2.0	2.1

Cashflow Analysis		2011A	2012E	2013E	2014E
EBITDA	**m**	**206**	**262**	**280**	**270**
Tax Paid	m	-28	-38	-42	-40
Chgs in Working Cap	m	-63	-20	-25	-26
Net Interest Paid	m	-0	-0	0	0
Other	m	66	37	-5	-4
Operating Cashflow	**m**	**180**	**241**	**208**	**201**
Acquisitions	m	-68	1	0	0
Capex	m	-139	-94	-90	-90
Asset Sales	m	0	0	0	0
Other	m	53	0	0	0
Investing Cashflow	**m**	**-154**	**-93**	**-90**	**-90**
Dividend (Ordinary)	m	-88	-61	-95	-95
Equity Raised	m	1	-0	0	0
Debt Movements	m	-1	-2	0	0
Other	m	0	0	0	0
Financing Cashflow	**m**	**-87**	**-64**	**-95**	**-95**
Net Chg in Cash/Debt	**m**	**-60**	**85**	**23**	**16**
Free Cashflow	**m**	**41**	**148**	**118**	**111**

Balance Sheet		2011A	2012E	2013E	2014E
Cash	m	149	234	258	273
Receivables	m	240	223	247	271
Inventories	m	176	203	228	250
Investments	m	109	108	108	108
Fixed Assets	m	680	708	729	748
Intangibles	m	20	20	20	20
Other Assets	m	23	25	25	25
Total Assets	**m**	**1,397**	**1,521**	**1,615**	**1,695**
Payables	m	203	192	216	237
Short Term Debt	m	0	0	0	0
Long Term Debt	m	2	0	0	0
Provisions	m	0	0	0	0
Other Liabilities	m	44	114	118	116
Total Liabilities	**m**	**250**	**306**	**334**	**352**
Shareholders' Funds	m	1,123	1,190	1,255	1,318
Minority Interests	m	25	25	25	25
Other	m	0	0	0	0
Total S/H Equity	**m**	**1,147**	**1,215**	**1,281**	**1,343**
Total Liab & S/H Funds	**m**	**1,397**	**1,521**	**1,615**	**1,695**

All figures in MYR unless noted.
Source: Company data, Macquarie Research, March 2012

MALAYSIA

HART MK Underperform

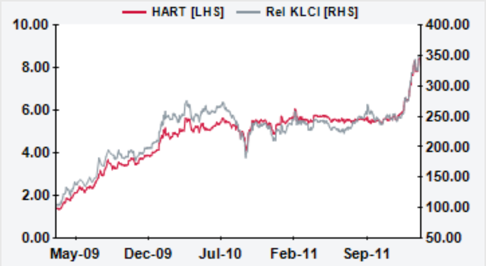
Close Price* 28 Feb 12 RM8.36

12-month target	**RM**	**7.20**
Upside/Downside	**%**	**-13.9**
Valuation	**RM**	**7.20**
- PER		
GICS sector		
Health Care Equipment & Services		
Market cap	**RMm**	**3,048**
30-day avg turnover	**US$m**	**1.0**
Market cap	**US$m**	**1,008**
Number shares on issue	**m**	**364.6**

Investment fundamentals

Year end 31 Mar		2011A	2012E	2013E	2014E
Revenue	m	734.9	914.3	1,028.1	1,169.0
EBIT	m	245.4	258.6	274.0	279.8
EBIT growth	%	35.4	5.4	6.0	2.1
Reported profit	m	190.3	201.8	219.3	223.9
Adjusted profit	m	190.3	201.8	219.3	223.9
EPS rep	sen	52.4	55.5	60.3	61.6
EPS rep growth	%	33.1	6.0	8.7	2.1
EPS adj	sen	52.4	55.5	60.3	61.6
EPS adj growth	%	33.1	6.0	8.7	2.1
PER rep	x	16.0	15.1	13.9	13.6
PER adj	x	16.0	15.1	13.9	13.6
Total DPS	sen	21.0	27.8	30.2	30.8
Total div yield	%	2.5	3.3	3.6	3.7
ROA	%	44.2	38.3	35.2	31.2
ROE	%	44.9	36.8	33.1	28.8
EV/EBITDA	x	10.7	9.9	9.3	9.0
Net debt/equity	%	-15.8	-24.7	-26.6	-30.2
P/BV	x	6.1	5.0	4.2	3.6

HART MK rel KLCI performance



Source: FactSet, Macquarie Research, February 2012
(all figures in MYR unless noted)

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1 March 2012
Macquarie Capital Securities (Malaysia) Sdn. Bhd.

Hartalega

"Nitrilization" not shining

Event

- We are initiating coverage on Hartalega, the world's largest nitrile glove manufacturer, with an Underperform recommendation and RM7.20 target price, offering 12% potential downside from the current price. We believe 2012 will be a tipping point for Hartalega as it hopes to maintain its market share and profit margin, while facing intensified competition from natural rubber glove manufacturers who have started to increase nitrile glove production in 2012.

Impact

- **Capacity expansion to help maintain its lead.** With the completion of its Plant 5 expansion in Jan 2012, and Plant 6 in the final approval stage, by mid-2013 Hartalega would have 13bn pcs pa installed capacity. Despite forecasting a drop in profit margin, Hartalega should still be able to maintain positive net profit growth for the next few years as new capacity comes online.
- **Profit margins under pressure as competition intensifies.** Hartalega is the pioneer in the nitrile glove segment; with the introduction of lightweight nitrile gloves and its high productivity production lines, the company is currently the most profitable glove manufacturer in Malaysia. But we foresee its profit margin dropping from 26% in FY11 to 20% in FY14 as competition intensifies in the nitrile rubber glove segment.
- **A market leader waiting to prove itself.** As the leading nitrile glove producer, Hartalega will face intense pressure in 2012 to maintain its market share, as most natural rubber glove manufacturers have started to produce nitrile gloves as well. We think Hartalega will need to prove to the market that it has the ability to overcome the competition and hold on to its premium valuation.

Earnings and target price revision

- Establishing FY12 and FY13 EPS estimates of 55.5sen and 60.3sen. Based on our target price of RM7.20, the implied FY12 and FY13 PERs are 13x and 12x, respectively.

Price catalyst

- 12-month price target: RM7.20 based on a PER methodology.
- Catalyst: Increase in nitrile rubber prices, which would slow the demand for nitrile rubber glove

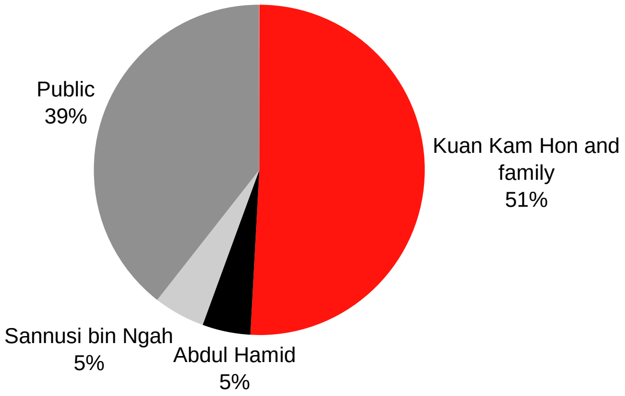
Action and recommendation

- The shares are **currently trading at 15x FY12E PER**, at a premium to the sector's historical average of 13x forward PER. We think the shares are overvalued as Hartalega, in our view, still needs to prove that it is the true industry leader.
- Hence, we believe it deserves an Underperform recommendation. Our target price is RM7.20.

Company profile

Hartalega started in 1981 as a one-line-operation and has since evolved into the leading nitrile glove manufacturer in the world. It was listed on the Main Board of Bursa Malaysia in April 2008 as Hartalega Holdings Berhad.

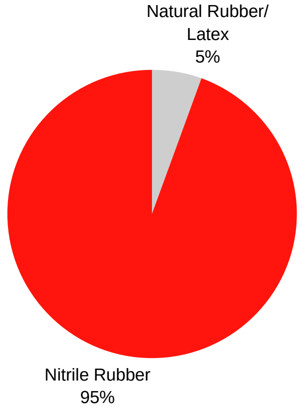
Fig 1 Hartalega shareholding structure (as of 22 June 2011)



Source: Company data, Macquarie Research, February 2012

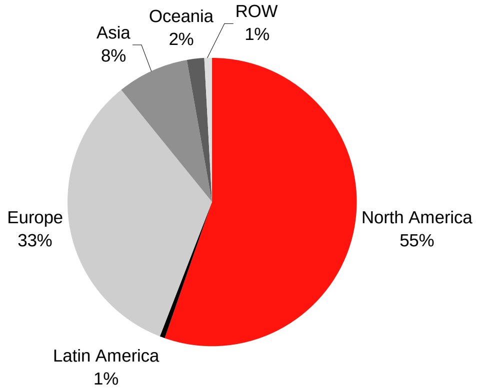
Hartalega's principal activities include the manufacture and sale of latex examination gloves. It is one of the first rubber glove manufacturers to start focusing on the production of nitrile gloves. Hartalega gloves are sold mainly to developed countries.

Fig 2 Production breakdown by type



Source: Company Data, Macquarie Research, February 2012

Fig 3 Sales breakdown by region

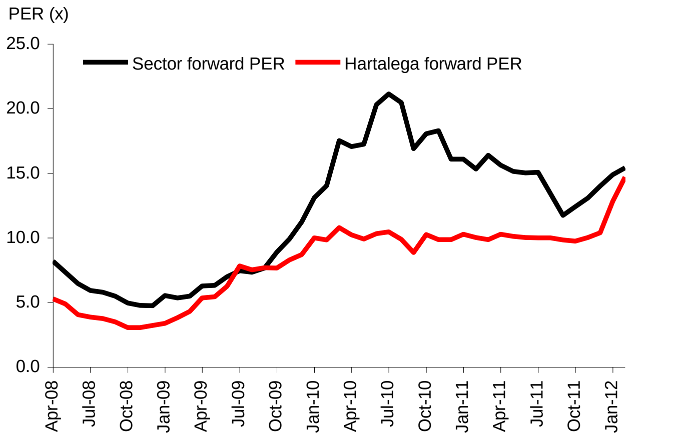


Source: Company Data, Macquarie Research, February 2012

Hartalega is managed by its founder Mr Kuan Kam Hon and his family members. Mr Kuan, age 64, is currently serving as both Executive Director and Managing Director of the company. He remains actively involved in the company's daily operations with the help of his sons Kuan Mun Leong (Deputy Managing Director) and Kuan Mun Keng (Group Corporate Finance Director). Mr Kuan's experience in the industry should help the company navigate through the impending overcapacity issues in the industry.

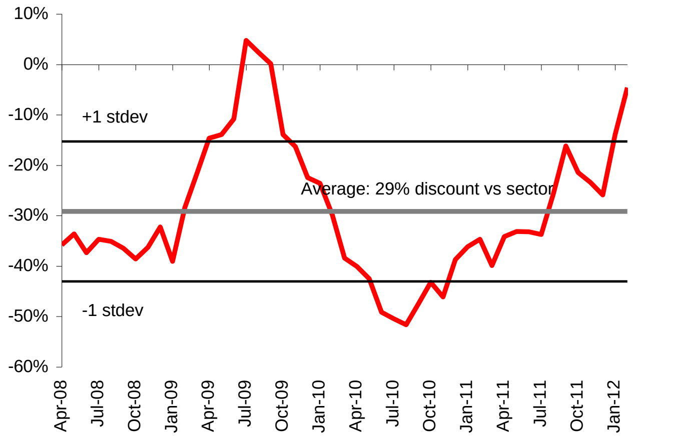
Expensive valuation for an unproven industry leader, Target Price: RM7.20

Fig 4 Hartalega valuation discount gap to the sector valuation is narrowing



Source: Bloomberg, Macquarie Research, February 2012

Fig 5 Hartalega used to trade at a 29% discount to the sector forward PER

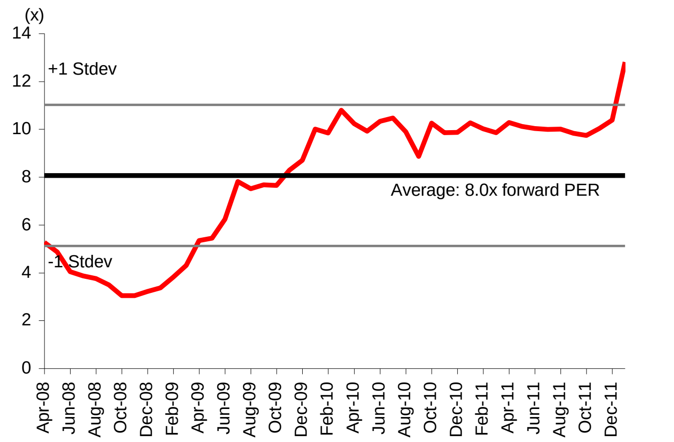


Source: Bloomberg, Macquarie Research, February 2012

We value the stock based on the 5-year historical industry forward PER of 13x PER instead of using the stock's historical forward PER, due to:

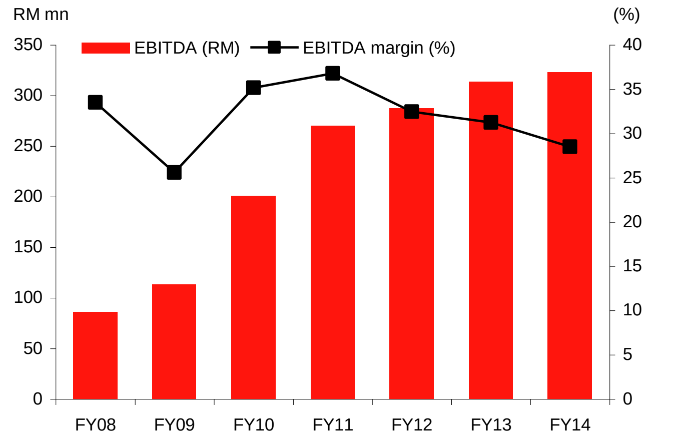
⇒ **Hartalega is now a pure nitrile glove play.** When Hartalega first listed in 2009, its production mix was 20% latex and 80% nitrile; this has since swung to 5% latex and 95% nitrile as of last quarter. The change in the business model has made its historical average PER valuation less comparable to other natural latex glove manufacturers given the different dynamics of nitrile glove.

Fig 6 Hartalega historical PER no longer reflects the company's business model



Source: Bloomberg, Macquarie Research, February 2012

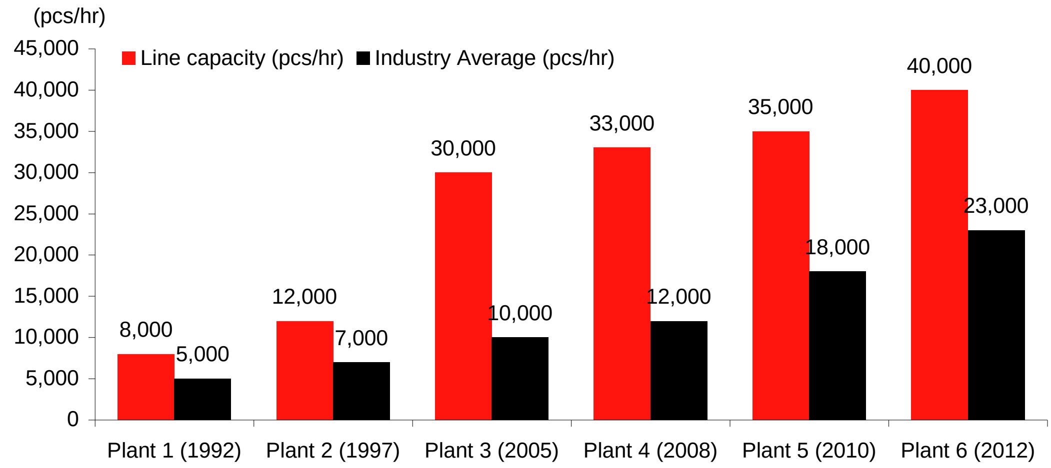
Fig 7 EBITDA margin on a downward trend, *but* EBITDA is still on the rise



Source: Bloomberg, Macquarie Research, February 2012

⇒ **Most profitable glove maker.** In FY11, Hartalega successfully transformed itself into the most profitable listed glove maker in Malaysia; it is also viewed as a pioneer in the industry. Despite trading above the sector's historical average forward PER of 13x, we are still cautious on the company's ability to defend its market share as competition looks set to intensify in 2H12. As we discuss in our sector report, industry players with higher market share tend to trade at a premium relative to peers with smaller market share.

Fig 8 Better line capacity output than peers

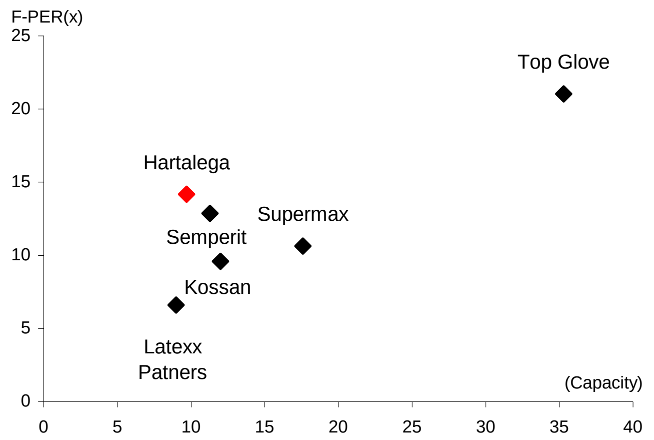


Source: Company Data, Macquarie Research, February 2012

Hartalega should be valued using the historical industry forward PER as:

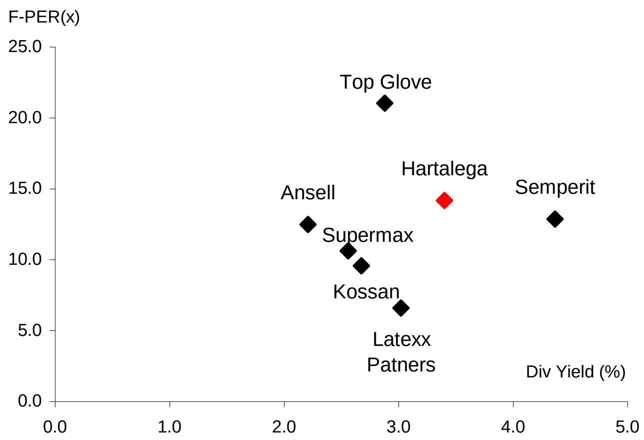
⇒ **Premium valuation for the industry leader.** As the industry leader in the nitrile glove segment, Hartalega technically should deserve to trade at a premium to its peers. However, we think otherwise, as compared to the other industry players, Hartalega's total installed capacity is still relatively small at 10bn pieces pa, although this is set to rise to 13bn by end-2013. As other rubber glove manufacturers have started to increase their nitrile glove production capacity, we think Hartalega will have to slash its selling prices to compete for orders. The tipping point is likely to be in 2H12, when the new nitrile glove production lines of the other natural rubber glove manufacturers are scheduled to come online.

Fig 9 Premium valuation for industry leaders, but Hartalega is still small in comparison



Source: Bloomberg, Macquarie Research, February 2012

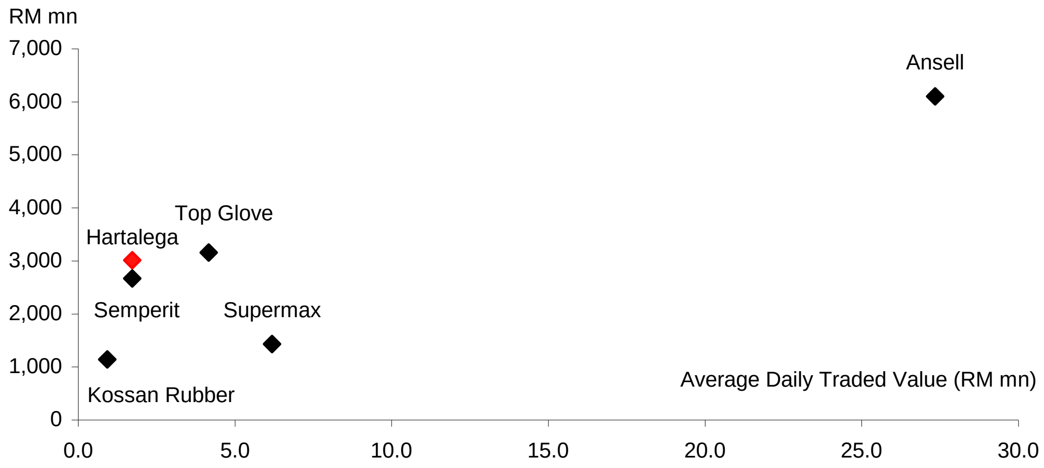
Fig 10 Hartalega – 3.3% dividend yield is higher than industry average at 3%



Source: Bloomberg, Macquarie Research, February 2012

⇒ **Dividend yield above its peers.** Despite having the highest dividend yield among the Malaysia's rubber glove manufacturers (Hartalega 3.4% vs the industry average 3%), we still think that Hartalega is overvalued. We believe that Hartalega's higher dividend yield is to compensate investors for the lack of liquidity in the stock. Hartalega's average daily trading value of RM1.7m is 40% of Top Glove's RM4.2m and 27% of Supermax's RM6.2m. Hartalega also has the highest dividend payout policy in our rubber glove coverage at 50%, and we expect it to pay 27.8sen and 30.2sen DPS for FY12 and FY13.

Fig 11 Hartalega is less liquid compared to peers

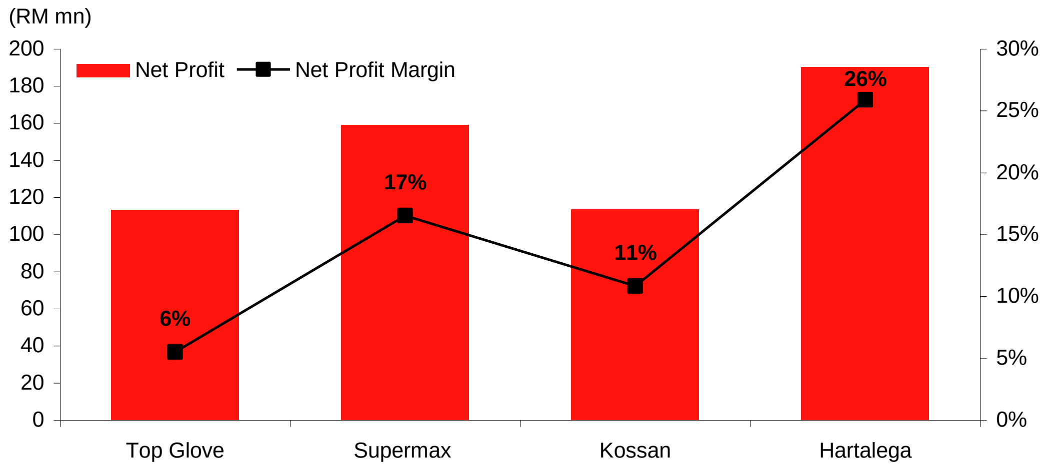


Source: Bloomberg, Macquarie Research, February 2012

Solid business model, poised to maintain market leadership

- **The leading nitrile glove manufacturer.** Although it is only the fifth-largest glove producer in Malaysia, Hartalega is the largest nitrile glove manufacturer in the world. It introduced the world's first lightweight nitrile glove in 2003, allowing the company to transform itself from just another glove manufacturer into the world's leading nitrile glove manufacturer. Despite the increase in competition in nitrile glove in recent quarters, Hartalega still manages to be the most profitable company in the sector.

Fig 12 Hartalega is the most profitable rubber glove manufacturer in Malaysia



* Based on the latest full year results
Source: Bloomberg, Macquarie Research, February 2012

- **Plant 5 started production in Jan 2012.** According to management, the Plant 5 extension plan was completed in Jan 2012. The 6% increase in capacity comes well ahead of its competitors' new production facilities, which are set to start operations in 2H12. This gives Hartalega some lead time in securing additional orders before the inflow of new capacity by competitors in 2H12.
- **Plant 6 will be the game changer in 2H12.** The first production line of Plant 6 is expected to start operations in mid-2012; the entire facility should be completed by mid-2013. We think that the new plant will be a game changer for the industry, as this would give Hartalega the extra capacity to absorb more orders. We expect a price war to ensue, as industry players would have to lower prices to compete for orders in order to fill their increased capacity.

- **Venturing into China.** Earlier this year, Hartalega announced that it has subscribed to 70% of the registered capital of YanCheng Pharmatex Medical Equipment in China. The China company is involved in trading of medical supplies. We think that the China examination glove market is still in its infancy stage, and we do not expect any significant contribution from this division. We do, however, believe this move will be beneficial in the long term, as we expect glove usage in China to eventually increase closer to the level in developed countries.

Hartalega (HART MK, Underperform, Target Price: RM7.20)

Quarterly Results		3Q/12A	4Q/12E	1Q/13E	2Q/13E
Revenue	**m**	**242**	**223**	**235**	**252**
Gross Profit	**m**	**81**	**81**	**83**	**88**
Cost of Goods Sold	m	161	142	152	164
EBITDA	**m**	**73**	**72**	**73**	**78**
Depreciation	m	9	9	10	10
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**64**	**63**	**63**	**69**
Net Interest Income	m	-0	-0	-0	-0
Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	0	0	0	0
Pre-Tax Profit	**m**	**64**	**63**	**63**	**69**
Tax Expense	m	-13	-13	-13	-14
Net Profit	**m**	**51**	**50**	**51**	**55**
Minority Interests	m	0	0	0	0
Reported Earnings	**m**	**51**	**50**	**51**	**55**
Adjusted Earnings	**m**	**51**	**50**	**51**	**55**
EPS (rep)	sen	13.9	13.8	13.9	15.1
EPS (adj)	sen	13.9	13.8	13.9	15.1
EPS Growth yoy (adj)	%	3.6	-6.1	-7.4	19.1
EBITDA Margin	%	30.2	32.2	31.2	31.1
EBIT Margin	%	26.6	28.3	27.0	27.2
Earnings Split	%	25.1	24.9	23.1	25.0
Revenue Growth	%	28.6	16.1	7.0	9.8
EBIT Growth	%	2.9	-6.3	-11.0	14.3

Profit and Loss Ratios		2011A	2012E	2013E	2014E
Revenue Growth	%	28.5	24.4	12.4	13.7
EBITDA Growth	%	34.5	8.6	6.8	3.1
EBIT Growth	%	35.4	5.4	6.0	2.1
Gross Profit Margin	%	40.6	35.7	34.1	31.6
EBITDA Margin	%	36.8	32.1	30.5	27.6
EBIT Margin	%	33.4	28.3	26.7	23.9
Net Profit Margin	%	25.9	22.1	21.3	19.1
Payout Ratio	%	40.1	50.1	50.0	50.0
EV/EBITDA	x	10.7	9.9	9.3	9.0
EV/EBIT	x	11.8	11.2	10.6	10.4
Balance Sheet Ratios					
ROE	%	44.9	36.8	33.1	28.8
ROA	%	44.2	38.3	35.2	31.2
ROIC	%	59.9	48.8	48.2	42.2
Net Debt/Equity	%	-15.8	-24.7	-26.6	-30.2
Interest Cover	x	99.3	148.1	6,297.8	8,584.2
Price/Book	x	6.1	5.0	4.2	3.6
Book Value per Share		1.4	1.7	2.0	2.3

Profit & Loss		2011A	2012E	2013E	2014E
Revenue	**m**	**735**	**914**	**1,028**	**1,169**
Gross Profit	**m**	**298**	**326**	**351**	**370**
Cost of Goods Sold	m	437	588	677	799
EBITDA	**m**	**270**	**293**	**313**	**323**
Depreciation	m	25	35	39	43
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**245**	**259**	**274**	**280**
Net Interest Income	m	-2	-2	-0	-0
Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	0	0	0	0
Pre-Tax Profit	**m**	**243**	**257**	**274**	**280**
Tax Expense	m	-53	-55	-55	-56
Net Profit	**m**	**190**	**202**	**219**	**224**
Minority Interests	m	-0	0	0	0
Reported Earnings	**m**	**190**	**202**	**219**	**224**
Adjusted Earnings	**m**	**190**	**202**	**219**	**224**
EPS (rep)	sen	52.4	55.5	60.3	61.6
EPS (adj)	sen	52.4	55.5	60.3	61.6
EPS Growth (adj)	%	33.1	6.0	8.7	2.1
PE (rep)	x	16.0	15.1	13.9	13.6
PE (adj)	x	16.0	15.1	13.9	13.6
Total DPS	sen	21.0	27.8	30.2	30.8
Total Div Yield	%	2.5	3.3	3.6	3.7
Weighted Average Shares	m	363	364	364	364
Period End Shares	m	364	364	364	364

Cashflow Analysis		2011A	2012E	2013E	2014E
EBITDA	**m**	**270**	**293**	**313**	**323**
Tax Paid	m	-48	-44	-55	-56
Chgs in Working Cap	m	-45	-21	-34	-17
Net Interest Paid	m	-2	-2	-0	-0
Other	m	-49	-12	0	0
Operating Cashflow	**m**	**126**	**215**	**225**	**251**
Acquisitions	m	-3	3	0	0
Capex	m	-81	-60	-80	-80
Asset Sales	m	0	0	0	0
Other	m	0	0	0	0
Investing Cashflow	**m**	**-85**	**-57**	**-80**	**-80**
Dividend (Ordinary)	m	-57	-87	-102	-110
Equity Raised	m	60	0	0	0
Debt Movements	m	-2	-24	-15	-0
Other	m	0	0	0	0
Financing Cashflow	**m**	**1**	**-111**	**-117**	**-110**
Net Chg in Cash/Debt	**m**	**42**	**48**	**28**	**60**
Free Cashflow	**m**	**45**	**155**	**145**	**171**

Balance Sheet		2011A	2012E	2013E	2014E
Cash	m	117	165	193	253
Receivables	m	97	89	111	121
Inventories	m	65	88	114	127
Investments	m	4	0	0	0
Fixed Assets	m	349	378	419	455
Intangibles	m	0	0	0	0
Other Assets	m	0	0	0	0
Total Assets	**m**	**631**	**720**	**836**	**957**
Payables	m	54	44	58	65
Short Term Debt	m	15	10	0	0
Long Term Debt	m	24	5	0	0
Provisions	m	0	0	0	0
Other Liabilities	m	44	56	56	56
Total Liabilities	**m**	**137**	**116**	**114**	**121**
Shareholders' Funds	m	494	604	722	835
Minority Interests	m	0	0	0	0
Other	m	0	0	0	0
Total S/H Equity	**m**	**495**	**604**	**722**	**836**
Total Liab & S/H Funds	**m**	**631**	**720**	**836**	**957**

All figures in MYR unless noted.
Source: Company data, Macquarie Research, February 2012

MALAYSIA

SUCB MK Underperform

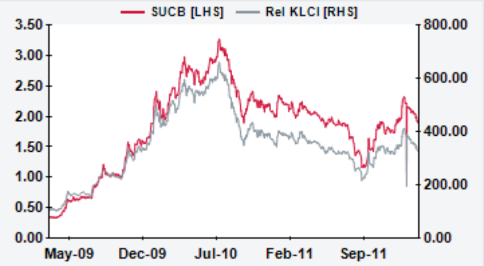
Close Price* 28 Feb 12 RM1.93

12-month target	**RM**	**1.49**
Upside/Downside	**%**	**-22.8**
Valuation	**RM**	**1.49**
- PER		
GICS sector		
Health Care Equipment & Services		
Market cap	**RMm**	**1,313**
30-day avg turnover	**US$m**	**2.0**
Market cap	**US$m**	**434**
Number shares on issue	**m**	**680.2**

Investment fundamentals

Year end 31 Dec		2011A	2012E	2013E	2014E
Revenue	m	1,026.9	1,024.0	1,145.6	1,224.2
EBIT	m	95.2	106.7	117.3	124.4
EBIT growth	%	-38.9	12.1	9.9	6.1
Reported profit	m	106.1	119.7	130.9	137.6
Adjusted profit	m	110.1	119.7	130.9	137.6
EPS rep	sen	12.5	17.6	19.2	20.2
EPS rep growth	%	-46.7	41.0	9.3	5.1
EPS adj	sen	14.1	17.6	19.2	20.2
EPS adj growth	%	-39.7	24.7	9.3	5.1
PER rep	x	15.5	11.0	10.0	9.5
PER adj	x	13.7	11.0	10.0	9.5
Total DPS	sen	2.4	5.3	5.8	6.1
Total div yield	%	1.2	2.7	3.0	3.1
ROA	%	8.5	8.6	8.6	8.2
ROE	%	15.1	14.8	14.6	13.9
EV/EBITDA	x	17.8	8.6	7.8	7.4
Net debt/equity	%	28.5	24.6	20.5	14.5
P/BV	x	3.4	1.5	1.4	1.3

SUCB MK rel KLCI performance



Source: FactSet, Macquarie Research, February 2012
(all figures in MYR unless noted)

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29 February 2012
Macquarie Capital Securities (Malaysia) Sdn. Bhd.

Supermax Corp

A follower's story

Event

- We are initiating coverage on the world's second-largest rubber glove manufacturer, Supermax, with an Underperform recommendation and target price of RM1.49, equivalent to 23% potential downside from the current price. We believe 2012 will be a challenging year for Supermax, as we are expecting slower growth and lower profit margins.

Impact

- **Completion of Lot 42 will boost its surgical glove profile.** With the completion of the Lot 42 production facility, Supermax expects to increase its surgical glove production capability to 336m pieces a year from 30m currently. We believe that the expansion will help improve profitability but **expect** only **limited contribution** from surgical gloves as they only contribute less than 10% of Supermax's top line.
- **Diversifying into synthetic gloves.** Supermax had also installed interchangeable lines in its production facilities. We view this as positive, as Supermax is now able to produce higher-margin nitrile gloves. However, we think that these higher margins are not sustainable heading into 2H 2012, as we are expecting a price war due to oversupply in the industry.
- **Overly optimistic consensus.** We think that the consensus is overly optimistic on the recovery story of Supermax, as they are expecting Supermax net profit for FY12 and FY13 to grow by 22% and 15%, respectively compare to our forecast of 9% for both years. We believe that the consensus is yet to take the impending oversupply situation of nitrile glove into consideration, and we are expecting a derating of the stock as consensus cut their estimates.

Earnings and target price revision

- Establishing FY12 and FY13 EPS estimates of 17.6sen and 19.3sen. Based on our target price of RM1.49, FY12E implied PER would be at 8.4x.

Price catalyst

- 12-month price target: RM1.49 based on a PER methodology.
- Catalyst: Delay in expansion plan would hamper its growth while increase in natural rubber price would hamper profit margins.

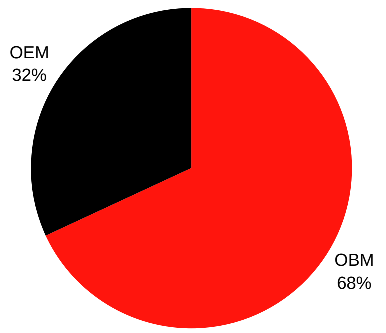
Action and recommendation

- At 11.0x FY12E PER (vs the historical average of 8.2x) and limited growth potential, we see 26% downside to Supermax's share price over the next 12 months. Our view that the stock is overvalued is further supported by our expectation that a price war will ensue in 2012. We have an Underperform rating on the shares with a target price of RM1.49.
- For our sector views/themes, please see our initiation note, *Malaysia rubber gloves sector – Overcapacity remains an issue*, 29 February.

Company profile

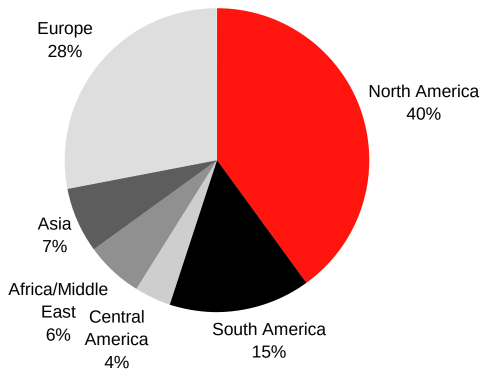
Started in 1989 and listed on Bursa Malaysia in August 2000, Supermax has since grown into the world's second-largest rubber glove manufacturer, with nine manufacturing plants located in Malaysia. Supermax also operates six distribution centres in the US, Brazil, Europe, Australia and Canada. Supermax currently has a production capacity of 17.6bn pieces pa, while maintaining a 13% market share.

Fig 1 3Q FY11 sales mix



Source: Company data, Macquarie Research, February 2012

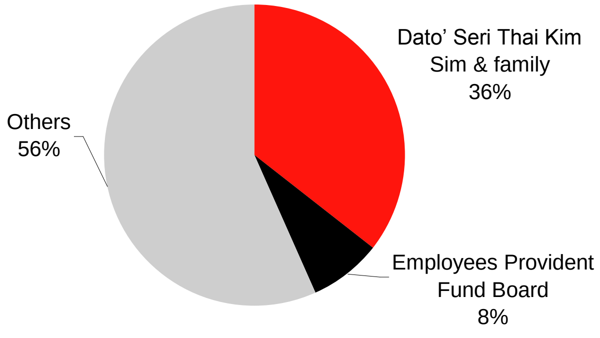
Fig 2 3Q FY11 sales breakdown by region



Source: Company data, Macquarie Research, February 2012

Supermax's principal activities involve the distribution and manufacturing of rubber gloves. Its main focus has been in the development of its own brand; currently 68% of its sales are in the original brand manufacturer (OBM) segment. Supermax's OBM products are sold mainly to dental, scientific laboratory and healthcare service providers.

Fig 3 Supermax's shareholding structure (as of May 2011)

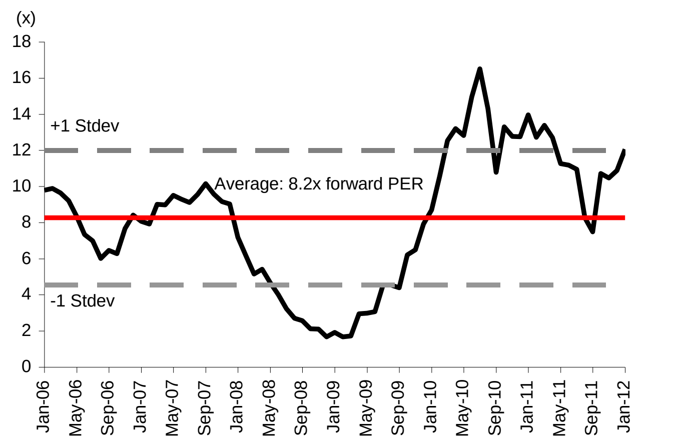


Source: Company Data, Macquarie Research, February 2012

Supermax's day-to-day operations are currently handled by company founders Dato' Seri Stanley Thai and Datin Seri Cheryl Tan, who, despite having no prior experience in the rubber glove industry, have managed to grow the company into the world's second-largest rubber glove manufacturer.

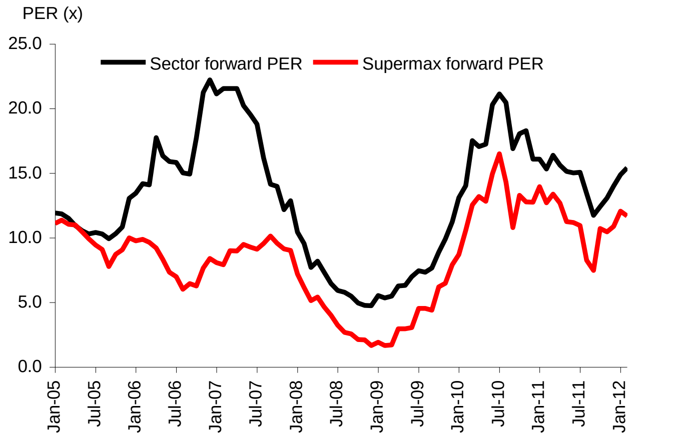
High valuation with low dividend yield; Target Price: RM1.49

Fig 4 Supermax is currently trading above its historical average of 8.2x forward PER



Source: Bloomberg, Macquarie Research, February 2012

Fig 5 Supermax is trading at a 24% discount to the sector average

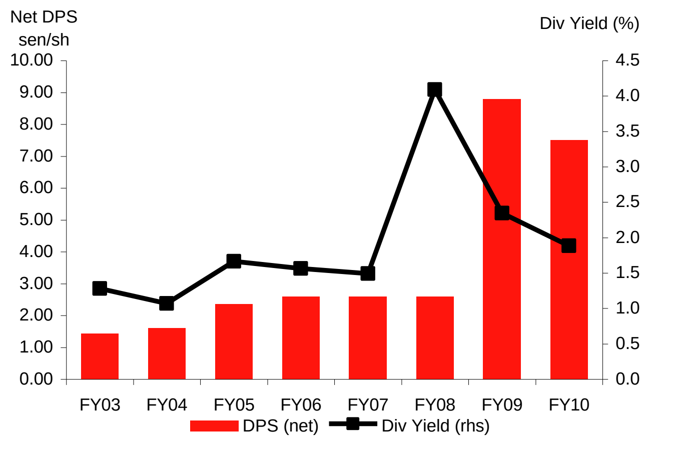


Source: Bloomberg, Macquarie Research, February 2012

We value the stock at RM1.49 based on 8.4x forward PER, which applies the historical 35% discount at which the stock has traded to the sector. The stock is currently trading above its 5-year average of 8.2x forward PER. We think the stock is expensive based on the following reasons:

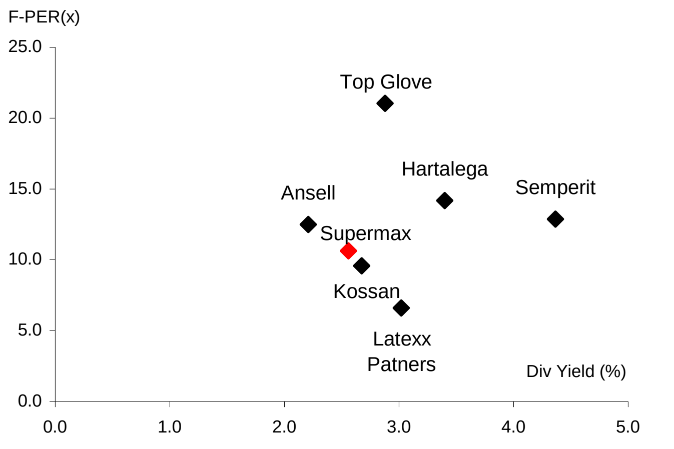
⇒ **Increase in dividend payout from 20% to 30% of PAT has been factored into the valuation.** We believe the market has already factored in the increase in dividend payout, as the stock is currently trading at 2.5% FY12E dividend yield, which is lower than the industry average of 3%. We expect FY12 and FY13 DPS at 5.3sen and 5.8sen. Based on our target price; the stock has an implied dividend yield of 3.5%, placing it above its peers.

Fig 6 Supermax has the lowest dividend payout and dividend yield under our coverage



*Dividend Yield calculated based on financial year end stock price
Source: Bloomberg, Macquarie Research, February 2012

Fig 7 Dividend yield at 2.7% makes it the lowest in our rubber glove sector coverage



Kossan Rubber, Latexx Patner and Semperit are not rated
Top Glove – TOPG MK, RM4.92, UP, TP:4.10;
Hartalega, HART MK, RM8.40, UP, TP: 7.20;
Supermax, SUCB MK, RM1.93, UP, TP:1.49
Ansell, ANN AU, A$14.48, OP, TP: A$16.00 (Covered by, Craig Collie)
Source: Bloomberg, Macquarie Research, February 2012

⇒ **Distribution of its own rubber glove brand does not generate higher margins.** We do not think the stock should trade on a par with its international peers notwithstanding having its own branded distribution network. Most of its international peers secure long-term procurement contracts with healthcare service providers, which generate higher margins, while Supermax's distribution network focuses on dental and scientific laboratories, which tend to have shorter contract terms and lower margin.

⇒ **Corporate exercises keep investor at bay.** Supermax's track record in its corporate strategy has been a concern for investors. A failed acquisition of two competitors in 2005 took three years to write off the books, and the discrepancy between the reported unaudited 4Q results and annual audited report has also raised doubts about its accounting process. We think it is difficult for investors to justify a higher premium for the company as investors would generally prefer companies with a better track record, as shown in Fig 7 above.

Is consensus too optimistic? Our net profit numbers for FY12 are 11% below consensus, while our FY13 forecast is 15% below consensus. We think that 2012 will continue to be a tough year for Supermax, despite the aim to have a 50% balance between nitrile and natural rubber gloves production capacity. As we are expecting nitrile gloves segment to face overcapacity by 2H12 too, 2H12 results will be the derating catalyst for Supermax as slower profit growth will prompt consensus to cut their profit forecast.

Fig 8 Consensus is underestimating the impact of overcapacity issue

(RM m)	Macquarie	Consensus	Diff
Net Profit (FY2012)	120	135	-11.0%
Net Profit (FY2013)	131	154	-15.2%
Net Profit (FY2014)	138	166	-16.9%
EBITDA (FY2012)	138	152	-9.6%
EBITDA (FY2013)	151	180	-15.9%
EBITDA (FY2014)	160	223	-28.1%

Source: Bloomberg, Macquarie Research, February 2012

Downside risk to our valuation would be a worse-than-expected price war and further delay in Supermax expansion plan.

"Another" rubber glove manufacturer

- **Diversifying into nitrile glove.** Supermax is aiming to maintain a 50% balance between nitrile and natural rubber gloves by the end of 2013. Despite nitrile gloves are still able to selling at a higher profit margin than the natural rubber gloves, we do not think that the higher margins are still achievable after 2H12. We believe that by 2H12, nitrile glove segment will start to face will overcapacity issue to, as most of the new nitrile glove production capacity is expected to be operational by then. Rubber gloves manufacturers will have to cut selling price in order to protect their marker share.

Fig 9 Production capacity expansion plan

Factory	Location	No. of additional lines	Capacity pa	Target completion
Current	Supermax	100	12.7bn pcs	NA
	Spenser	53	4.9bn pcs	NA
Expansion:				
Lot 42	Sg Buloh, Malaysia	4	0.2bn pcs	Dec - 2011
Lot 6058	Klang, Malaysia	12	1.2bn pcs	Sept - 2013
Lot 6059	Klang, Malaysia	26	2.6bn pcs	Sept - 2012
Glove City (Phase 1)	Klang, Malaysia	32	4.2bn pcs	Dec - 2014
	Total	**74**	**8.2bn pcs**	

Source: Company Data, Macquarie Research, January 2012

- **Expansion plan is in place for future growth.** Lot 42 was completed in 4Q11, which will expand Supermax's surgical glove production capacity by 10x (from 30m pieces to 336m pieces). Despite the surge in production capacity, we expect the impact to be limited, as surgical glove contributes less than 10% of Supermax's revenue. Lot 6058 and Lot 6059 are on schedule to be operational in 3Q13 and 3Q12, which will increase its current capacity by 1.2bn and 2.6bn pieces pa, respectively. Despite the newly installed capacity features interchangeable lines, we feel that the expansion comes at a bad time, given our expectation of a price war in 2H12; this may force Supermax to cut selling prices ion order to compete for orders.
- **No surprise from the distribution business.** Despite having dual sales channels, we do not think that Supermax's distribution division will benefit from the price war. As pointed out by management, its distribution business is focused mainly on dental and elderly care home service providers, who are more price-sensitive than healthcare services providers, who are more concerned about glove quality and thus provide higher margins.

Supermax Corp (SUCB MK, Underperform, Target Price: RM1.49)

Quarterly Results		4Q/11A	1Q/12E	2Q/12E	3Q/12E
Revenue	**m**	**276**	**248**	**250**	**260**
Gross Profit	**m**	**54**	**56**	**53**	**54**
Cost of Goods Sold	m	222	192	197	205
EBITDA	**m**	**35**	**37**	**34**	**34**
Depreciation	m	7	8	8	8
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**28**	**29**	**26**	**26**
Net Interest Income	m	-3	-3	-4	-4
Associates	m	4	11	10	10
Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	0	0	0	0
Pre-Tax Profit	**m**	**29**	**37**	**32**	**33**
Tax Expense	m	-1	-4	-3	-3
Net Profit	**m**	**28**	**33**	**29**	**29**
Minority Interests	m	0	0	0	0
Reported Earnings	**m**	**28**	**33**	**29**	**29**
Adjusted Earnings	**m**	**28**	**33**	**29**	**29**
EPS (rep)	sen	2.1	4.8	4.2	4.3
EPS (adj)	sen	2.1	4.8	4.2	4.3
EPS Growth yoy (adj)	%	-52.5	34.7	8.3	-5.3
EBITDA Margin	%	12.7	14.7	13.4	13.1
EBIT Margin	%	10.1	11.6	10.3	10.1
Earnings Split	%	25.6	27.5	24.1	24.4
Revenue Growth	%	12.1	2.9	5.0	-4.4
EBIT Growth	%	19.4	56.3	34.8	-12.2

Profit & Loss		2011A	2012E	2013E	2014E
Revenue	**m**	**1,027**	**1,024**	**1,146**	**1,224**
Gross Profit	**m**	**206**	**218**	**242**	**257**
Cost of Goods Sold	m	821	806	904	967
EBITDA	**m**	**125**	**138**	**151**	**160**
Depreciation	m	29	31	34	36
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**95**	**107**	**117**	**124**
Net Interest Income	m	-13	-15	-17	-19
Associates	m	35	41	45	48
Exceptionals	m	-4	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	0	0	0	0
Pre-Tax Profit	**m**	**113**	**133**	**145**	**153**
Tax Expense	m	-7	-13	-15	-15
Net Profit	**m**	**106**	**120**	**131**	**138**
Minority Interests	m	0	0	0	0
Reported Earnings	**m**	**106**	**120**	**131**	**138**
Adjusted Earnings	**m**	**110**	**120**	**131**	**138**
EPS (rep)	sen	12.5	17.6	19.2	20.2
EPS (adj)	sen	14.1	17.6	19.2	20.2
EPS Growth (adj)	%	-39.7	24.7	9.3	5.1
PE (rep)	x	15.5	11.0	10.0	9.5
PE (adj)	x	13.7	11.0	10.0	9.5
Total DPS	sen	2.4	5.3	5.8	6.1
Total Div Yield	%	1.2	2.7	3.0	3.1
Weighted Average Shares	m	850	680	680	680
Period End Shares	m	1,360	680	680	680

Profit and Loss Ratios		2011A	2012E	2013E	2014E
Revenue Growth	%	5.1	-0.3	11.9	6.9
EBITDA Growth	%	-31.5	10.6	9.8	6.0
EBIT Growth	%	-38.9	12.1	9.9	6.1
Gross Profit Margin	%	20.1	21.3	21.1	21.0
EBITDA Margin	%	12.1	13.5	13.2	13.1
EBIT Margin	%	9.3	10.4	10.2	10.2
Net Profit Margin	%	10.3	11.7	11.4	11.2
Payout Ratio	%	16.8	30.0	30.0	30.0
EV/EBITDA	x	17.8	8.6	7.8	7.4
EV/EBIT	x	21.9	10.4	9.4	8.9
Balance Sheet Ratios					
ROE	%	15.1	14.8	14.6	13.9
ROA	%	8.5	8.6	8.6	8.2
ROIC	%	10.0	9.7	9.9	9.8
Net Debt/Equity	%	28.5	24.6	20.5	14.5
Interest Cover	x	7.3	7.3	7.0	6.4
Price/Book	x	3.4	1.5	1.4	1.3
Book Value per Share		0.6	1.3	1.4	1.5

Cashflow Analysis		2011A	2012E	2013E	2014E
EBITDA	**m**	**125**	**138**	**151**	**160**
Tax Paid	m	-7	-13	-15	-15
Chgs in Working Cap	m	-48	-11	-40	-19
Net Interest Paid	m	-13	-15	-17	-19
Other	m	4	17	49	55
Operating Cashflow	**m**	**61**	**116**	**129**	**162**
Acquisitions	m	4	0	0	0
Capex	m	-46	-70	-60	-60
Asset Sales	m	0	0	0	0
Other	m	0	0	0	0
Investing Cashflow	**m**	**-42**	**-70**	**-60**	**-60**
Dividend (Ordinary)	m	-27	-22	-36	-39
Equity Raised	m	0	0	0	0
Debt Movements	m	28	55	57	60
Other	m	-13	-15	-17	-19
Financing Cashflow	**m**	**-13**	**18**	**4**	**1**
Net Chg in Cash/Debt	**m**	**7**	**65**	**73**	**103**
Free Cashflow	**m**	**15**	**46**	**69**	**102**

Balance Sheet		2011A	2012E	2013E	2014E
Cash	m	104	169	242	345
Receivables	m	208	197	220	230
Inventories	m	210	193	213	225
Investments	m	0	0	0	0
Fixed Assets	m	402	455	481	505
Intangibles	m	29	29	29	29
Other Assets	m	232	241	250	260
Total Assets	**m**	**1,185**	**1,284**	**1,436**	**1,594**
Payables	m	59	24	27	28
Short Term Debt	m	158	165	190	216
Long Term Debt	m	165	213	246	279
Provisions	m	0	0	0	0
Other Liabilities	m	33	28	29	30
Total Liabilities	**m**	**415**	**431**	**492**	**554**
Shareholders' Funds	m	771	853	944	1,041
Minority Interests	m	-0	-0	-0	-0
Other	m	0	0	0	0
Total S/H Equity	**m**	**770**	**853**	**944**	**1,041**
Total Liab & S/H Funds	**m**	**1,185**	**1,284**	**1,436**	**1,594**

All figures in MYR unless noted.
Source: Company data, Macquarie Research, February 2012

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell)– return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Australian/NZ/Canada stocks only

Recommendations – 12 months
Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2011

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	56.59%	65.60%	54.55%	44.53%	75.28%	49.46%	(for US coverage by MCUSA, 10.53% of stocks covered are investment banking clients)
Neutral	33.45%	20.55%	38.96%	50.20%	22.47%	32.36%	(for US coverage by MCUSA, 10.96% of stocks covered are investment banking clients)
Underperform	9.96%	13.85%	6.49%	5.27%	2.25%	18.18%	(for US coverage by MCUSA, 0.44% of stocks covered are investment banking clients)

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