

# Asia Glovemakers

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Latex prices continue to fall – earnings upside

## Short-term upside from ongoing decline in NRL, medium-term upside from Chinese demand

**We update our TPs for lower near-term input costs – the latex price is down 20% since April 2011 due to increasing rubber inventories.**

**Should a slowdown occur, industrial glovemakers revenues should be solid, whilst there is weaker bargaining power for medical glovemakers. In addition, we believe there is potential for medium-term revenue upside from ongoing hospital expansion in China.**

**We believe the risk-reward picture is favourable for Supermax (BUY) and Ansell (BUY from Neutral). We downgrade Top Glove (REDUCE from Neutral) and Kossan Rubber (NEUTRAL from Buy).**

### Key analysis in this anchor report includes:

- We expect earnings rebounds in 2012 of c10% to 56% for the Malaysian glovemakers under coverage due to the latex price easing.
- Medical glove market demand has grown by 8-10% pa over the past decade, in contrast to aggregate capacity growth of 23% pa.
- In China, we believe glove use in hospitals is low despite their critical role in infection control. As the standard of living and quality of healthcare in China increases, we believe this will lead to increased demand for better quality gloves.

September 27, 2011

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September 27, 2011

## Latex prices continue to fall – earnings upside Short-term upside from ongoing decline in NRL, medium-term upside from Chinese demand

### Action: Lower input costs – NRL price down 20% since April 2011

Post easing of Natural Rubber Latex (NRL) prices off their highs due to increasing industry inventories, from MYR10.9/kg to MYR8.73/kg currently, we have updated our FY12F NRL price to MYR8.50/kg (from MYR8-9/kg across the glovemakers). Hence, FY12F earnings expected to increase by 10-56% for the Asian names under our coverage.

### Catalyst: Should a slowdown occur, industrial glove revenue likely to be solid, with weaker bargaining power for medical glovemakers

The majority of ANN's earnings come from the Industrial gloves segment (51% of FY12F EBIT). Even with our lower industrial growth forecast (which correlates with its Industrial division revenue growth) in FY12 compared to pcp, we believe industrial glove growth for ANN should be solid, as Nomura expects an increase in emerging economies' manufacturing in from low US inventory levels. Also, ANN's bargaining power as a net examination glove purchaser is likely to remain strong vs the listed Malaysian examination glovemakers, given the latter's FY12F capacity growth of 15%, versus current output growth of 2-3%.

### In addition, medium-term revenue upside from China

In line with recent government reforms, China is increasing the breadth and quality of medical services, while we believe glove use in hospitals is low in spite of glove use being critical for infection control. As the standard of living and quality of healthcare in China increases, we believe this will lead to an increased demand for better quality gloves, i.e., away from easily ruptured vinyl gloves to higher-quality latex/nitrile gloves, which the Asian glove providers can supply. Malaysian glovemakers' sales to Asia remain c10% of total sales (China estimated at <5% of total). We think this has the potential to increase over the medium-term.

### Valuation: We update our forecasts and recommendations

At current share prices, we believe the risk-reward picture is favourable for Supermax (BUY reiterated) and Ansell (BUY from Neutral). We move to a REDUCE (from Neutral) on Top Glove given: 1) unfavourable valuation despite our earnings growth rebound forecast in 2012F; and 2) lower visibility, given Top Glove has a higher latex product mix than peers.

Fig. 1: Stocks for Action

Company	Code	Rating	Price	Price target	Up/downside (%)	P/E FY11F	P/E FY12F
Ansell	ANN AU	Buy	12.99	15.25	17.4	14.0*	12.6
Kossan	KRI MK	Neutral	2.60	2.51	(3.5)	7.4	6.7
Supermax	SUCB MK	Buy	2.37	2.88	21.5	7.4	5.3
Top Glove	TOPG MK	Reduce	4.00	3.42	(14.5)	22.0	14.1

Priced as at 23 September 2011. TOPG, SUCB, KRI quoted in MYR, ANN in AUD. \* based on actual reporting earnings  
Source: Nomura research, Bloomberg

Rating: See report end for details of Nomura's rating system.

### Anchor themes

Easing costs are likely to remove earnings pressure on medical glovemakers, but near-term demand visibility remains limited on continued capacity expansions. However, we believe there is potential for medium-term revenue upside from ongoing hospital expansion in China.

### Nomura vs consensus

We are c5% above consensus for ANN, given our new FY12F NRL price. We are in line for Malaysia.

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# Executive summary

*We believe that near- and medium-term demand for gloves should be solid.*

## Short-term opportunity: input costs lower, change in MYR/USD assumptions

Malaysian glovemakers stocks have underperformed over the past 12 months, with glove players such as Top Glove, Supermax and Kossan Rubber falling an average of 27% in the past 52 weeks on the back of lower FY10 earnings growth and record-high latex prices. This is compared to a 4% downside move in the market. Post easing of latex prices off its highs (of MYR10.9/kg) to MYR8.73/kg currently, we expect an earnings rebound in 2012 of c10% to 56% for the Malaysian glovemakers under our coverage.

**Fig. 2: Change in key assumptions**

	2011F		2012F		2013F	
	old	new	old	new	old	new
RM / USD	3.3	2.90	3.3	2.77	na	2.68
Latex assumption (RM/kg)	8.5-8.8	9.2	8	8.5	na	7.5

Source: Nomura estimates

## Medium-term revenue upside from Chinese opportunity

The healthcare community requires medical gloves, both for examination and surgery, in order to provide a barrier that prevents transmission of micro-organisms to and from patients. In line with recent government reforms, China is increasing the breadth and quality of medical services. In China, we believe glove use in hospitals is low despite their use of gloves being critical for infection control. As the standard of living and quality of healthcare in China increases, we believe this will lead to an increased demand for better quality gloves, i.e. away from easily ruptured vinyl gloves to higher-quality latex and nitrile gloves, which the Asian glove providers can supply. As a result of our analysis, we believe that on a medium-term view, there is an increased opportunity for more latex and nitrile gloves from the Asian glove providers to be sold into China.

In China, we believe the use of gloves in hospitals is low despite their critical role in infection control

## Risk-reward increasingly favourable for some of the Asian glovemakers

Despite delayed expansion plans, most Malaysian glovemakers have not actually scrapped expansions and are in fact continuing with plans to switch capacity to nitrile gloves to balance their product mix. We believe consolidation has some ways to go, as most major glove manufacturers still have healthy balance sheets and low gearing ratios, and remain unwilling to risk ceding market share. For the Malaysian glovemakers under our coverage, we see a slower improvement in bargaining power given FY12F capacity expansions of 15% versus current output growth of 2-3% y-y (companies like Top Glove are currently seeing single-digit output growth over 2009).

However, at current share prices, the risk-reward picture is favourable for Supermax (BUY reiterated) as P/E valuations have corrected to single-digit valuations of upstream rubber names (which typically command lower multiples) and are at trough levels last seen during the 2008 period. Although Kossan is also at single-digit P/E valuations, it has the highest exposure to Western countries (c. 80%) versus peers, where minor consumables growth is forecast to moderate. Hence, we are downgrading the shares from Buy to NEUTRAL at these levels. ROEs for these companies are expected to stay in the high teens into 2012, owing to a more balanced product mix and slightly better demand visibility. Top Glove is a REDUCE given its unfavourable valuation despite our view of an earnings growth rebound into 2012, while visibility remains less certain as it still has a higher latex product mix than its peers.

For ANN, the majority of its earnings come from the Industrial gloves segment (51% of FY12F EBIT). ANN's industrial division revenue growth has tracked closely to industrial production. Even though we forecast lower industrial growth in FY12 compared to pcp, we believe industrial glove growth for ANN should be solid. We believe economic recovery is underway in the advanced economies, albeit driven by Japan, and would argue that this will continue to underpin ANN's Industrial division's earnings over the medium term. Growth in emerging economies is forecast to be relatively strong, where Nomura expects an increase in manufacturing activity in response to low US inventory levels. While we have made no changes to our revenue forecasts, the impact of changes to raw material costs has increased our EPS forecasts by 6.2% for FY12 and by 6.4% to for FY13.

# Updating our near-term input price assumptions

*Latex costs form the bulk of input costs for the Asian glovemakers.*

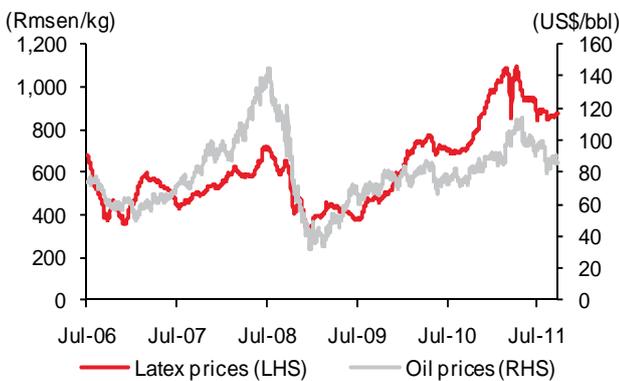
The International Rubber Study Group (IRSG) forecasts global demand for natural rubber to grow 3.8% (from an earlier forecast of 4.7%) in 2011 and 5.4% in 2012, while global production of natural rubber in 2011 is expected to grow 5.6% and 8.2% in 2012 due to the impact of higher prices and a surge in tapping and planting in Indonesia, Myanmar and Cambodia. IRSG anticipates that increased supplies might accelerate a 27% decline in the price of rubber from a record-high of JPY535.7/kg on 18 February 2011.

For the Malaysian companies, latex costs (encompassing both natural and synthetic types, depending on the product mix) as a percentage of total costs can range from 50% to 70%, depending on prevailing latex prices. Most of the glove players' latex comes from Thailand (between 50% and 80%), with the remainder sourced from Malaysian plantations. While latex supply is currently stable, we flag that Malaysia's natural rubber production, over the past five years, has been down 3.6% pa, whilst global natural rubber production has increased 3.0% pa over the same period. This implies a general downward supply trend for latex supplies from Malaysia, and should that persist, glove players will have to increase imports of latex from neighbouring countries. In this respect, Top Glove is the only glove manufacturer we cover that owns two latex concentrate plants in Thailand to secure a constant flow of latex. We feel this protects it from supply risks in the medium term.

### Rubber inventories starting to increase

Indeed, after a larger-than-usual supply deficit in 1H10's "wintering" season owing to strong demand from China and India, which caused a sharp rise in prices, a gradual recovery is being seen as rubber inventories are beginning to climb back up from their lows, and Thai exports have started to climb back up.

**Fig. 3: Latex prices vs oil prices**

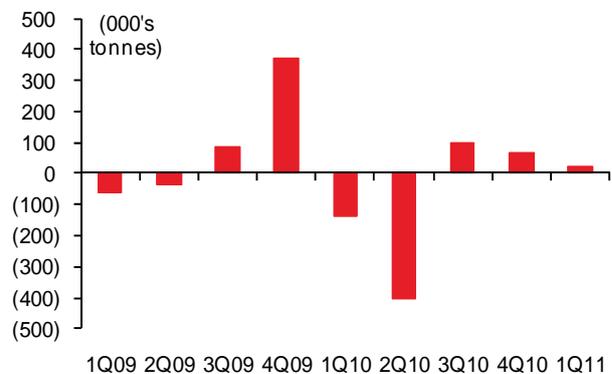


Source: Bloomberg

Hence, while the correction in rubber prices has been slow, indications are that prices are not likely to see a sharp spike given the improving supply/demand dynamics. Given this, we base our FY12F latex price assumptions at around current levels of MYR8.50/kg, below the FY12F year-to-date average price of MYR8.69/kg. We believe the glovemakers own expectations for the latex price is MYR7-8/kg, due to improving yields and moderate weather activity. Assuming the midpoint of MYR7.50/kg, this would imply a 15% reduction from the FY11A average price.

The International Rubber Study Group (IRSG) forecasts global demand for natural rubber to grow 3.8% (from an earlier forecast of 4.7%) in 2011

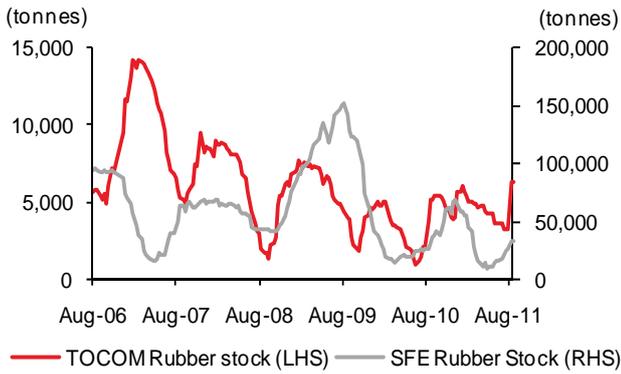
**Fig. 4: Global NRL supply/demand surplus/deficit**  
After a large supply deficit in 1H10's wintering season, a slow recovery is evident



Source: Bloomberg

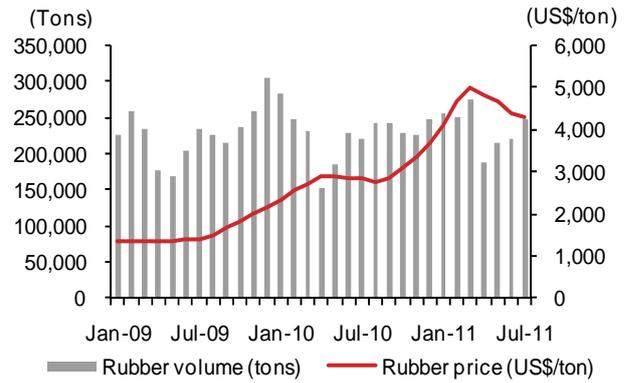
Hence, while the correction in rubber prices have been slow, indications are that prices are not likely see a sharp spike given improving supply/demand dynamics

**Fig. 5: Rubber inventories are starting to gradually build up**



Source: Bloomberg

**Fig. 6: Rubber exports from Thailand, the largest producer, have picked up going into 2H11**



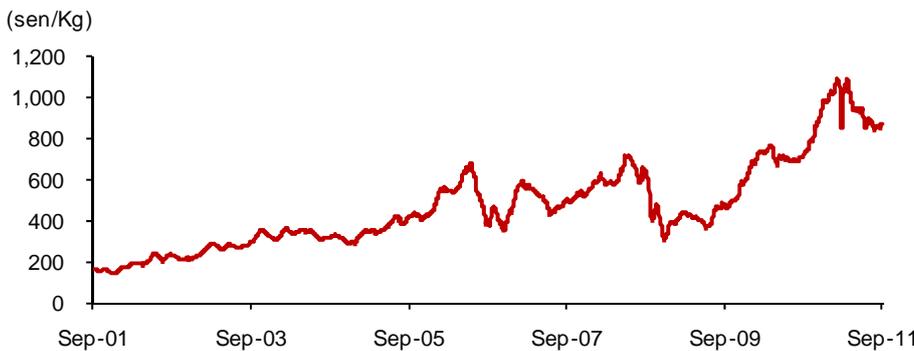
Source: Bank of Thailand

According to Ansell, raw materials account for approximately 35% of its total cost of sales, with NRL accounting for the largest component of expenditure. We believe that NRL has historically accounted for approximately 15% of ANN Group cost of sales. This figure can fluctuate by +/- 1% to 3%, subject to movements in the NRL price. In FY11A, c43% of ANN’s total revenue was derived from products that use NRL, albeit in varying degrees. The products with the largest reliance on NRL, where NRL accounts for more than 35% of COGS, are examination gloves and household gloves, which contribute 15% of total sales.

**Input price rises don’t necessarily get passed on**

Fluctuating NRL costs can lead to fluctuating margins, as Average Selling Prices take one- or two-month lags to adjust, and smaller players experience a higher degree of fluctuation. Glovemakers typically adjust their pricing monthly, but are still subject to price lags. For a short period of time in the early part of the year, Malaysian glovemakers had to adjust ASP every two weeks to account for the volatility in the rising NRL cost. Average NRL price for FY11 (June year-end) was MYR8.85/kg, 49% higher than the FY10 average of MYR5.96/kg. This compares to the year-to-date average price for FY12F of MYR8.69/kg, 2% lower than the FY11A average. The NRL price trend over the past 10 years is shown below.

**Fig. 7: Latex price volatility**

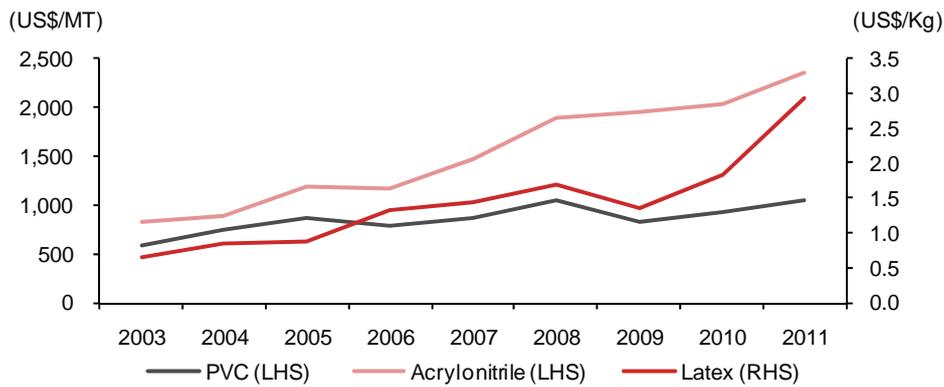


Source: Datastream

While volatile latex costs have led glovemakers to adjust ASPs frequently throughout FY11A, the degree of cost pass through has come under pressure due to softer demand. We believe the sector has achieved approximately 70% cost pass through in FY11A compared to 100% cost pass through in FY10A. This resulted in lower margins in FY11A.

Fluctuating NRL costs can lead to fluctuating margins as ASPs take one- or two-month lags to adjust

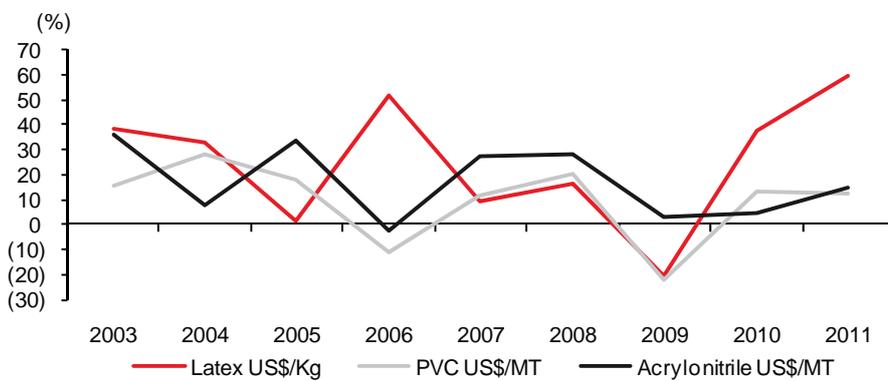
**Fig. 8: Average Annual input prices**



Source: Datastream

Should latex costs undergo sharp corrections amid normalising demand and increasing capacity, supplier power could moderate faster, in our view.

**Fig. 9: Change in average annual input cost prices (%)**



Source: Datastream

**Foreign currency movements**

Natural rubber latex is traded mainly in US dollars. We believe an appreciation in the currencies of natural rubber exporting countries against the US dollar aids natural rubber prices to increase in US dollar terms:

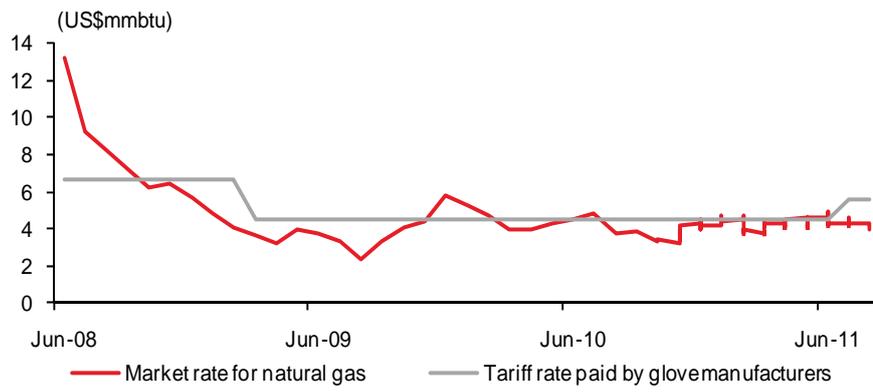
- **Thai baht:** we have analysed whether there is a correlation between the Thai baht and the price of Thai natural rubber. Using daily prices over the last two years, we found the R2 was 0.6244, which indicates a moderate co-variance of the Thai baht with the Thai natural rubber price;
- **Malaysian ringgit:** we have analysed whether there is a correlation between the Malaysian ringgit and the price of Malaysian natural rubber. Using daily prices over the last two years, we found the R2 was 0.6701, which indicates a moderate co-variance of the Malaysian ringgit with the Malaysian natural rubber price;
- **Japanese yen:** The value of the Japanese yen has a negative influence on the natural rubber price. During periods when the yen has depreciated, speculators invest in commodities, driving up prices such as the Tokyo Commodity Exchange (TOCOM) rubber futures. Using continuous daily prices over the last two years, we found the correlation coefficient was R2=0.2513, which indicates a low co-variance of the Japanese yen to the TOCOM rubber price.

There is moderate co-variance of the Malaysian ringgit with the Malaysian natural rubber price

**Gas costs**

Other costs are split fairly equally amongst labour, packaging and gas costs, typically comprising no more than 10% of costs. While tariff hikes have been announced recently for Malaysian manufacturers, we highlight that the current market price paid now is close to the market rate for natural gas.

**Fig. 10: Since 2008, the difference in the fixed tariff and market rates have narrowed**



Source: Bloomberg, News reports, Company data

# Near-term demand for examination gloves – solid

*We explore whether potential supply demand exceeds current demand.*

We conclude that, due to a series of recent expansions in capacity by the major players, demand for gloves is c6-8% lower than current potential supply. However, the reason for capacity expansion is readiness for a potential global threat that would require increased numbers of gloves, namely another outbreak of SARS or avian influenza.

In this section, we:

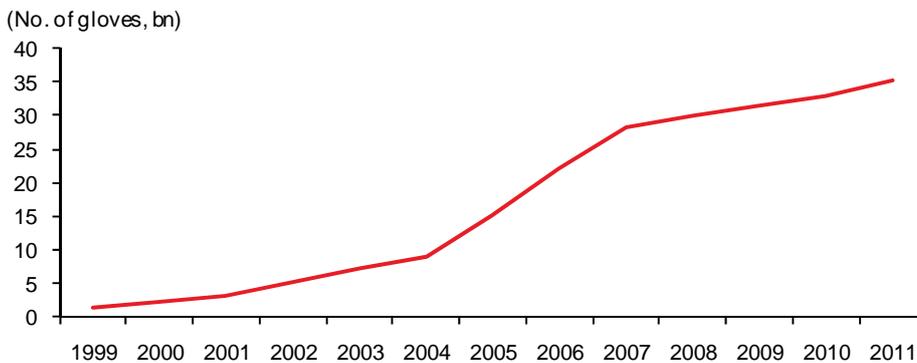
- Highlight the current state of global glove demand;
- Compare this with current and potential future supply of gloves;
- Evaluate whether excess capacity in the industry will erode company margins; and

## Global demand for gloves

There are two drivers of the global glove market: 1) the use of protective gloves within industry; and 2) the use of gloves within the healthcare space. We believe industrial glove use is related to the economy. Emerging from a mid-2010 “soft-patch,” the US economy appears to be entering a more secure phase of recovery. Nonetheless, powerful headwinds are likely to keep the pace of growth quite moderate in 2012. First, the sweeping reforms of the health care and financial services industries could impede hiring and investment. Second, household deleveraging should restrain consumption and put downward pressure on real estate prices. Third, fiscal policy is expected to be less favourable for growth. The positive impulse from the 2009 Recovery Act has now turned into drag, while state and local government budget pressures should weigh on outlays and employment. Finally, while we see some improvement in the housing sector, sales volumes and home-building are likely to remain depressed compared to pre-recession levels. We believe hospital glove use is related to the ongoing need for barrier protection for healthcare workers. The last few years has witnessed a rapid expansion of the medical gloves market globally, as awareness increases of the benefits of gloves in providing effective protection.

Due to a series of recent expansions in capacity by the major players, demand for gloves is c6-8% lower than current potential supply. However, the reason for capacity expansion is readiness for a potential global threat that would require increased numbers of gloves, namely another outbreak of SARS or avian influenza

**Fig. 11: Global annual demand for examination/surgical gloves**



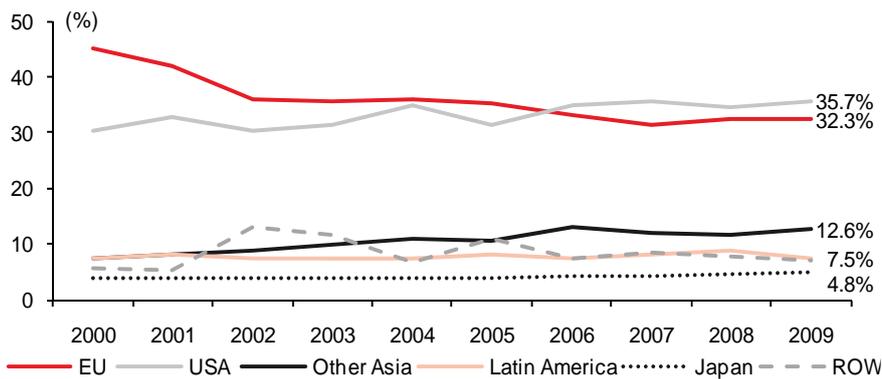
Source: Top Glove annual data

Global annual demand for examination gloves was estimated at 150bn pcs pa in 2011. Historically, the market has grown by 8-10% pa over the last decade. We expect these rates of growth to continue. For instance, every year, 3mn of 35mn healthcare workers are exposed to blood-borne pathogens (Hepatitis B, C and HIV). With the cancer diagnosis rate increasing exponentially (by 50% in 2020, according to WHO), more and more hazardous cytotoxics are being handled.

The US and EU27 accounted for 11% of world population but used 68% of glove manufactured on a global basis in 2009. In contrast, the rest of the world (ROW) accounted for 89% of the population and used only 32% of gloves produced globally.

Over time, we believe emerging markets will demand an increasing proportion of the total market for exam gloves.

**Fig. 12: Global examination/surgical glove usage by region**



Source: Malaysian rubber export promotion council and company

Going forward, we believe the key healthcare industry drivers of increasing glove use include:

- **Barrier protection:** Medical glove use is essential in the healthcare industry to serve as a protective barrier against infection and disease;
- **Emerging markets:** Increasing healthcare and hygiene awareness in developing countries;
- **Ageing population:** A greater proportion of population is living longer and therefore requiring more healthcare services;
- **Healthcare regulations:** Healthcare reform in the US and China. Application of healthcare regulations such as OSHA in US, EU-27 and SESI in Brazil; and
- **Emergence of health threats:** H1N1, SARS, bird flu, bio-terrorism threats such as Anthrax.

## Global supply of gloves

We believe the Malaysian glovemakers account for c60% of the global capacity for gloves. This position has been achieved through a combination of proximity to key raw materials, infrastructure, R&D, development of supporting industries and support from government agencies. This has been two decades in the making, has led to a competitive advantage for the Malaysian glovemakers, given their early headstart in the sector, in our view.

### Capacity analysis

Top Glove, Supermax, Kossan and others have all progressively increased capacity over the past decade.

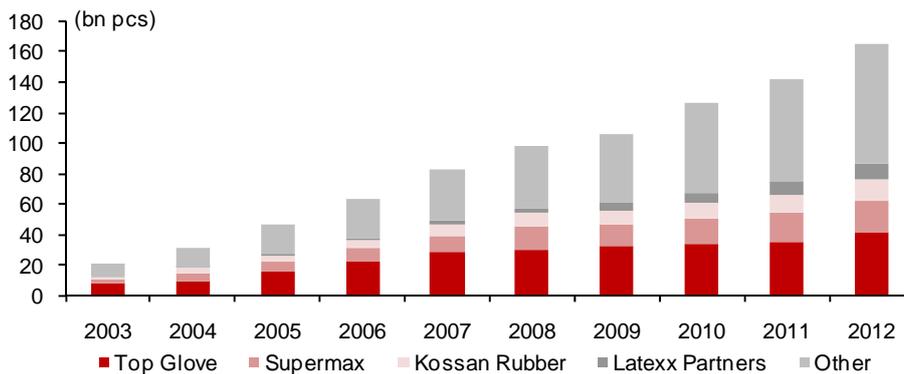
In particular:

- **Top Glove:** Top Glove is the market leader in Malaysia in terms of natural rubber glove capacity. It currently has 18 factories producing 35.25bn pcs, and is building three new factories (6.3bn pcs), which are scheduled to come on stream by May 2012. Expansions have been delayed for a third time owing to weak demand rebounds off 2010 highs, and the company is not planning any further expansions following these existing plans as yet;
- **Supermax:** The company only added 174mn pcs of capacity in 2011 owing to refurbishment of old lines, instead of adding new lines. The bulk of that increase in capacity has been focused mainly on surgical gloves. However for 2012, 2.6bn pcs of capacity are in the works, representing a 15% increase in capacity. According to the company, that remains on track.

We believe the Malaysian glovemakers account for c60% of the global capacity for gloves

- **Kossan:** The company is adding a total of c1.5-1.8bn pcs of capacity this year for both surgical and nitrile gloves, representing a 20% increase. However, we note that Kossan's expansions historically have been fairly slow and measured.

**Fig. 13: Estimated production capacity for examination/surgical gloves (bn pcs)**



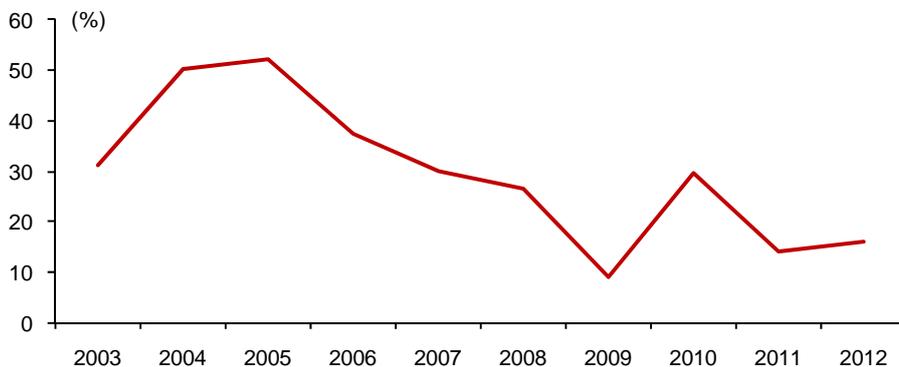
Source: Company data, Nomura estimates

**Nomura viewpoint**

Over the last decade, industry aggregate capacity has grown by a CAGR of 23% pa. In FY12, we forecast capacity to increase by 27bn pcs, or 16% on the prior year based on an aggregation of the glovemakers' announced expansion plans. Should FY12 demand continue to grow within its historical range of 8-10%, then we believe the market may continue to face a situation of excess supply, with glovemakers currently remaining unwilling to cede market share and still currently sporting fairly robust balance sheets and gearing levels. This could ensure that consolidation in the industry would have some ways to go. As seen in the following figure, growth in production capacity for examination/surgical gloves in forecast at 16% for FY12F.

We believe the Malaysian glovemakers currently remain unwilling to cede market share given robust balance sheets, hence capacity growth in FY12F is still 16% over historical demand growth of 8-10%

**Fig. 14: Growth in production capacity for examination/surgical gloves (%)**



Source: Nomura estimates

**However, the threat of oversupply remains**

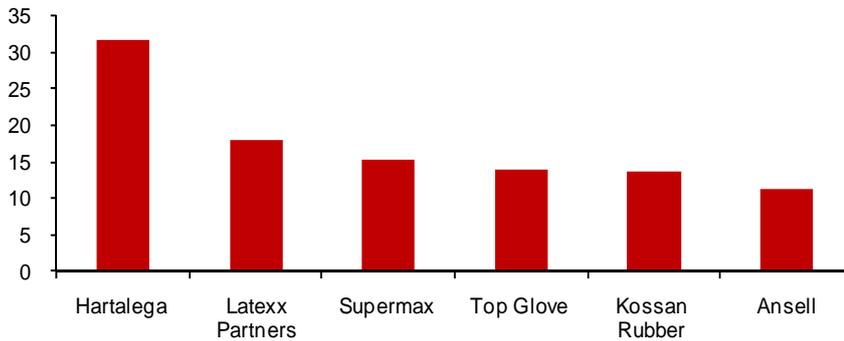
However, should demand repeat its FY10 performance and be flat on pcp, then the potential oversupply of gloves could be in the order of c15%. We view this as the potential worst-case scenario for the Asian glovemakers – although we have also highlighted potential extreme case scenarios at the end of the report should macro conditions deteriorate further.

**Will excess capacity in the industry erode company margins?**

Inevitably, excess capacity has the potential to erode company margins. However, we believe that the established larger producers may be less susceptible to margin erosion compared to their smaller competitors, given their scale, long presence in the industry and experience in dealing with the brunt of idle capacity situations. A prolonged period of excess capacity could force rationalisation of smaller, less profitable operators over the medium term.

As a consequence of this threat, we have analysed company EBIT margins and free cashflow per share for the Asian glove manufacturers, to better understand who would be best placed to survive a potential prolonged downturn in volume growth of global glove sales. This is shown in the following figures.

**Fig. 15: Last reported annual EBIT margins (%)**

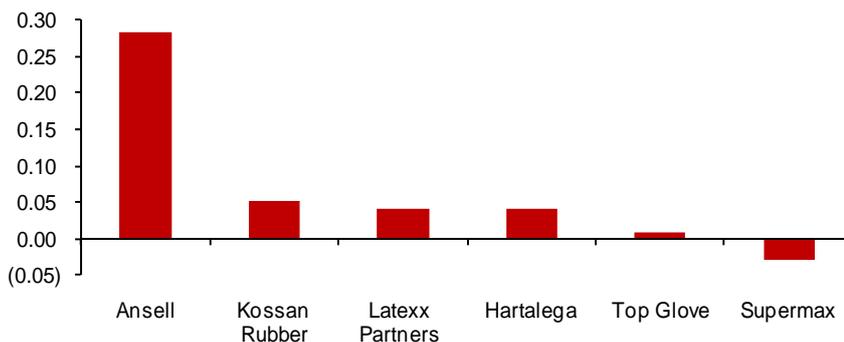


Source: Company data

We note that Hartalega (HART MK, unrated) has higher EBIT margins than its listed comparables, while Ansell has the highest free cashflow per share in USD terms. We believe strong cashflow, and room to compete on margin, will auger well for these companies should a downturn occur.

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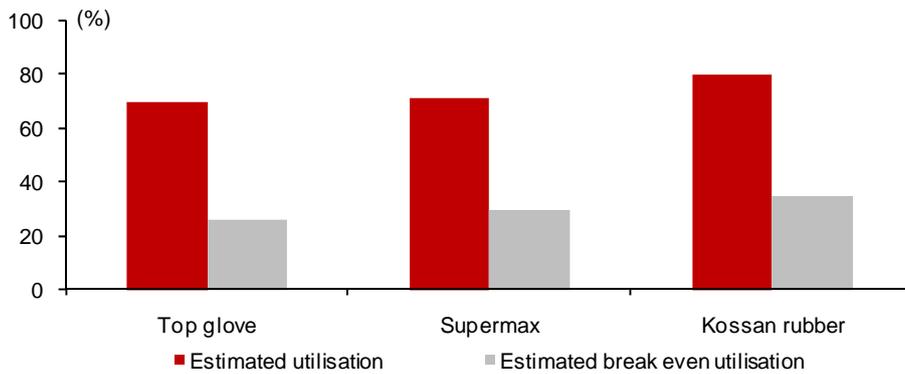
**Fig. 16: Last reported free cashflow (USD per share)**



Source: Company data

The other consideration is the companies' utilisation rates and its position relative to their respective breakeven levels. We believe that Top Glove has the lowest estimated FY12F breakeven utilisation rate of 26%, and is expected to be the least sensitive to any output declines. This is shown in the following figure, and compares to higher breakeven utilisation rates for Supermax and Kossan Rubber. Hence, Top Glove is most likely to be able to withstand any expanded downturn in volume growth for glove products.

We believe the reason for capacity expansion is the Asian glove manufacturers' willingness to be ready for a potential global threat that would require an increased numbers of gloves

**Fig. 17: Estimated utilisation rates across the glovemakers (%)**

Source: Company data, Nomura estimates

### **Why do the larger players continue to increase potential production?**

We believe the reason for capacity expansion is the Asian glove manufacturers' willingness to be ready for a potential global threat that would require increased numbers of gloves, namely another outbreak of H1N1, SARS or avian influenza. In the event of a future outbreak, global regulatory bodies are likely to require large number of gloves as part of barrier protection campaigns.

### **Potential consolidation in the market – in spite of capacity utilisation**

Over the last six months, listed Latexx Partners (LTX MK, unrated) has had two failed M&A bids for its businesses. While Latexx Partners remains open to further M&A activity, it has also completed expansion of its annual capacity from 6bn pcs to 9bn pcs and is currently working towards 12bn pcs in the next two years. By 2015, Latexx plans to have annual maximum output reach 15bn pcs. Should a worldwide downturn in glove volume growth occur, we believe the global glove manufacturing business could become more consolidated.

# Medium-term revenue upside? A review of the Chinese opportunity

*New demand will likely drive the growth in the use of medical gloves.*

To improve the balance of resource allocation between wealthy cities and the poor rural regions, we expect increasing government financial support to expand and improve facilities in the county hospitals. This new demand will likely drive the growth in the use of medical gloves, in our view.

In this section of the report, we:

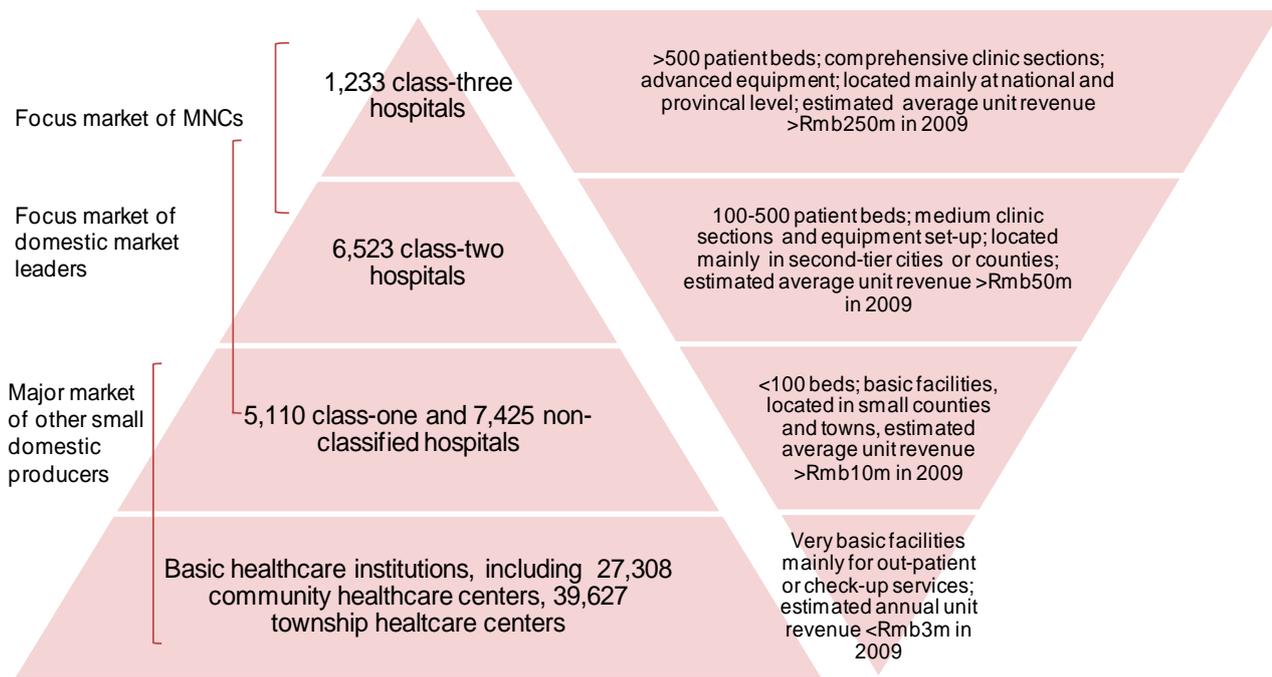
- Describe the market opportunity by outlining the medical services market in China and the rate and type of glove use in China;
- Explain whether Chinese vinyl glove manufacturers can switch to producing NRL or nitrile gloves; and
- Outline the current state of the market for gloves in China.

A disproportionate amount of China's healthcare resources has traditionally been concentrated on larger hospitals, particularly those in urban areas. More than 80% of health expenditures are allocated to urban areas, even though 70% of the total population resides in rural areas.

For example, the average number of outpatients per doctor in Ministry of Health (MOH)-owned hospitals is 7.3; in the next largest group, province-owned hospitals, the average is 6.2; and it is 4.4 in the smallest, city-owned hospitals. This is particularly problematic because larger hospitals are more expensive: average cost per outpatient in MOH hospitals is CNY234.8(USD28.36), as compared to CNY174.5 (USD21.08) at province hospitals and CNY77.2 (USD9.32) at city hospitals at the county level.

China is rolling out a large number of hospitals. As the standard of living and quality of healthcare demanded increases, we believe hospital staff will demand better quality gloves

**Fig. 18: Healthcare institutional structure in China**



Note: all estimates are based on 2009 MOH statistics  
 Source: MOH, Nomura research

## Reforms in train – will lead to increased volume growth for hospitals

We think hospitals are a key marketplace for glovemakers in China, accounting for over 30% of total sales. While the large hospitals in major cities remain the core market for many market players, we believe the country-level hospitals enjoy a faster growth outlook, given unparalleled support from the government's hospital system reform. The government has enacted a number of recent reforms, which should lead to more of the

large Chinese population visiting hospitals. In turn, this should lead to increased demand for medical examination and surgical gloves. We begin with a background on the need for ongoing reform in hospitals in China.

**Background**

Since the mid-1980s—with the collapse of the previous era's commune-based health system—the main impetus behind hospital reform in China has been to reduce the financial burden that hospital care places on government budgets.

In 1992, the Ministry of Health granted substantial financial autonomy to hospitals, allowing them to charge for their services and to sell drugs at a profit. They are now permitted to keep the surpluses that they generate, and they are responsible for their debts and operating losses. Reforms have encouraged growth in the number of hospitals and the volume of their activity. Though still a low number by international standards, there were 19,712 hospitals nationwide by 2008, an average of 2.2 hospital beds per 1,000 population and 1.2 township health centre beds per 1,000 rural population. About 20% of hospitals are private and for-profit (handling about 5% of total outpatient and inpatient services, though only about 1.5% of emergency cases). In addition, the 2003 SARS outbreak spurred a review of the public health functions of medical facilities.

Starting in 2000, medical institutions were classified as either for-profit or non-profit, depending on whether net income from operations is returned to investors. Non-profit medical institutions are operated for social and public benefit. Net income from operations can only be used for improving medical services, introducing technologies, and launching new medical projects. For-profit institutions return gains to investors. Based on their differing purposes and underlying character, the two kinds of institutions have different fiscal, taxation, and pricing policies.

In 2008, about 20% of hospitals (4,038) were classified as for-profit. Half of the for-profit hospitals are sponsored by either society groups or individuals. Outpatient departments and clinics are mostly for-profit (60% and 76%) and have non-government owners (94% and 96%). Community health service centres are mostly non-profit (92%) and have non-government owners (65%). Health centres are almost all non-profit (99%) with government owners (97%). Relative to their numbers, for-profit hospitals do not account for a proportionate quantity of services. About 20% of hospitals are for-profit, yet they provide only about 5% of total outpatient and inpatient services.

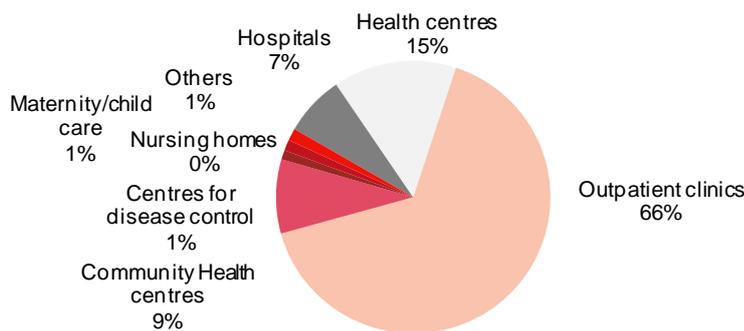
In 2008, more than half the clinical visits (in-hospital outpatient wards and emergency departments), observation cases, and physical check-ups were provided by hospitals.

Hospitals provided about two-thirds of inpatient admissions and discharges and more than 90% of inpatient surgeries and severe cases.

China has an average of 2.2 hospital beds per 1,000 population

Relative to their numbers, for-profit hospitals do not account for a proportionate quantity of services

**Fig. 19: China – number of health institutions by type**



Source: China National Health Yearbook (2009)

Public hospitals can purchase drugs, medical consumables, and small-scale medical equipment with full autonomy. The government does not directly intervene in internal finances and operations. However, it monitors and audits the financial status of public hospitals to maintain or increase the values of state-owned assets, and it supervises

medical behaviour and service quality to ensure that medical services are provided at a reasonable cost.

**What is the authority of the Ministry of Health regarding infection control and hence glove acquisition?**

Another factor contributing to the lack of high-quality patient care is the difficulty in monitoring the quality level of care within China’s very complex healthcare system. Currently, there is a lack of integrated health policies that apply to all hospitals. The provision and regulation of health service delivery is largely decentralized and managed by a multitude of different stakeholders, including the Ministry of Health, provincial and city governments, military, and even large state enterprises that continue to operate their own hospitals. This decentralization not only creates great variation in terms of quality of care across the healthcare system, it also makes it difficult to consistently monitor the level of care.

The Ministry of Health has limited authority within any particular province outside the Bureau of Health or its associated Centers for Disease Control. The Ministry of Health may formulate national policies, but these policies serve merely as guidelines or unfunded mandates for the lower levels of government, which must generate and allocate the funding needed to support their implementation.

In China, over 20,000 hospitals and many thousands of other basic healthcare institutions are the key final sales channel for medical gloves

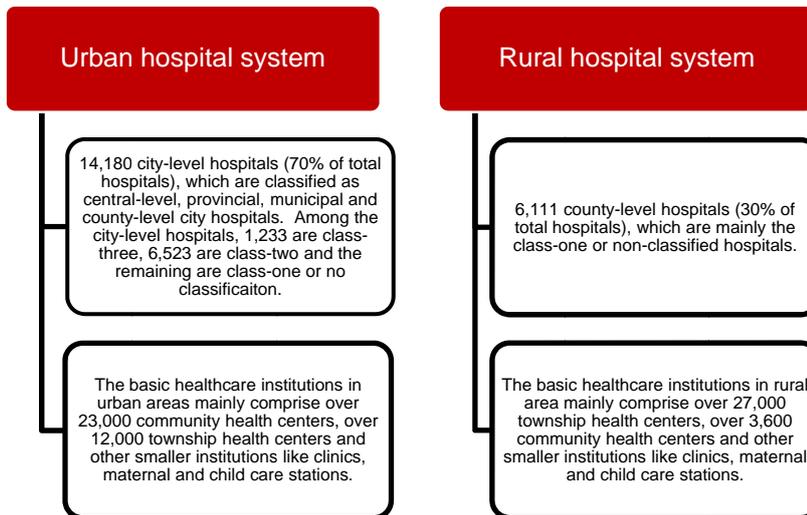
**Hospital system in rural and urban areas**

In China, over 20,000 hospitals and many thousands of other basic healthcare institutions are the key final sales channel for medical gloves. Given the fragmented hospital structure and complexity in distribution system, glove manufacturers seldom sell gloves directly to hospitals. Manufacturers usually go through two to four layers of distributors to reach the complicated hospital system. The main barrier to entry for a foreign-owned glovemakers so far has been operating methods that can differ from province to province – generally, direct selling by foreign firms is not allowed, and foreign companies either need to sell via a local distributor, establish a joint venture with a Chinese company, or incorporate a local venture.

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Given uneven allocation of government resources and different affordability between cities and rural areas, the distribution of healthcare facilities is not balanced and not uniform, which in turn affects the competitive landscape.

**Fig. 20: Hierarchy of hospital system in China**



Source: MOH, number of institutions are figures at the end of 2009

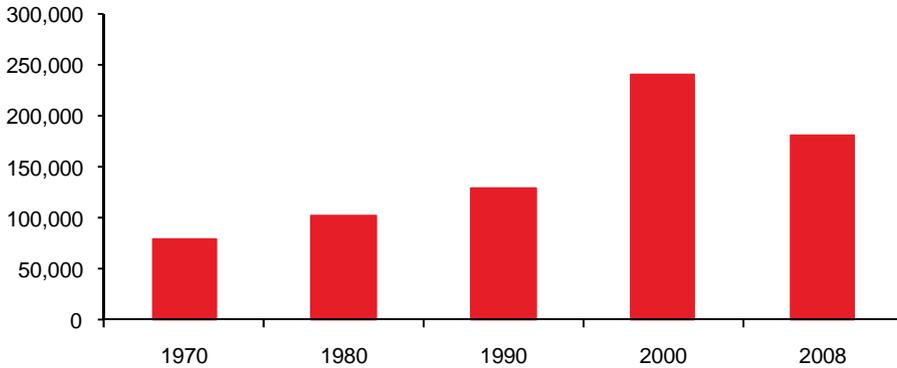
Although rural regions host some 70% of the total population, they get less than 30% of total healthcare spending in China.

The insufficient financial resources limit the affordability of hospitals and basic healthcare institutions in rural regions. However, the smaller rural hospitals can afford gloves and

low-end consumables. The growth in the number of outpatient facilities is shown in Figure 21.

Hospitals in urban areas typically have more money to spend. Nearly 70% of total hospitals in China are in cities, and most are the larger class-three and class-two hospitals. The concentration of more large hospitals means that major cities are the primary markets for the larger glove manufacturing companies.

**Fig. 21: China - number of outpatient facilities (2008)**



Source: China National Health Yearbook (2009)

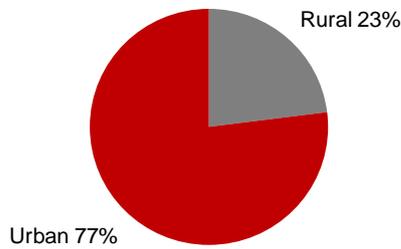
**Segregated demand between different tiers of healthcare institutions**

The major healthcare institution system in China can be broadly classified according to scale (class-three to class-one) and status in relation to the rural or urban governments. From bottom to top of the hierarchy, the major healthcare institutions for urban areas are community health centres, district hospitals, municipal hospitals, provincial hospitals and central level hospitals. The township health centres and county-level hospitals are the two major tiers of healthcare institutions in rural regions.

At the top of China's hospital system hierarchy, there are over 1,200 class-3 hospitals, of which over 760 are class-3A

**Fig. 22: Distribution of healthcare expenditure**

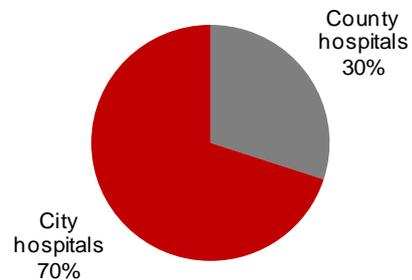
Health care expenditure was RMB1,720bn in 2009



Source: MOH

**Fig. 23: Distribution of number of hospitals**

China had 20,291 hospitals at end of 2009

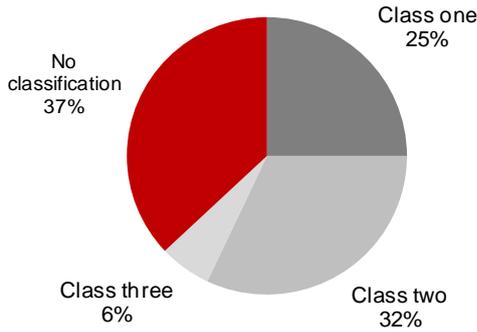


Source: MOH

At the top of China's hospital system hierarchy, there are over 1,200 class-3 hospitals, of which over 760 are class-3A, which are the largest hospitals located mainly in the capital or first-tier cities of all provinces in China. These 1,200 class-3 hospitals, of the over 900,000 healthcare institutions (hospitals + non-hospital healthcare institutions), generate circa 30% of total revenue for all healthcare institutions in China.

**Fig. 24: Distribution in number of hospitals based on three-class system (2009)**

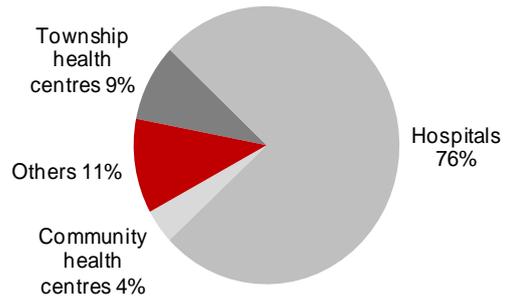
China had 20,291 hospitals by the end of 2009



Source: MOH

**Fig. 25: Distribution of revenue by institution (2009)**

Total revenue was CNY1,131bn in 2009



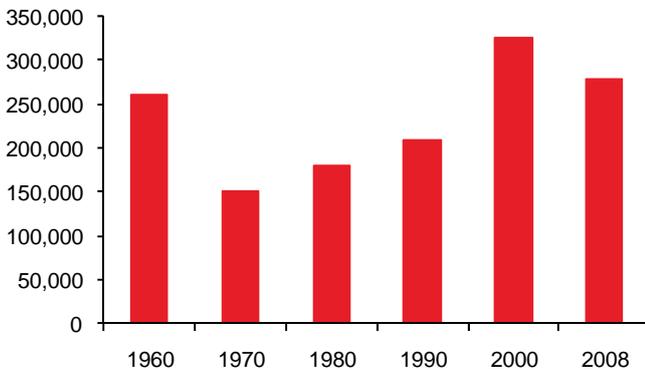
Source: MOH

In the second layer of the hospital hierarchy are over 6,500 class-two hospitals, mainly comprising the provincial and municipal-level hospitals. We estimate the class-two hospitals account for c35% of total revenue for all healthcare institutions in China. The domestic glove companies most likely have stronger sales and marketing platforms in the class-two hospitals due to their stronger connections with domestic distributors in the second-tier cities. Hospitals have been growing strongly, as shown in the following figures.

Further down the value chain of the hospital system are over 5,100 class-one hospitals and over 7,400 hospitals without classification, which mainly comprise the smallest hospitals located in the small counties and towns. We believe they account for 10-15% of overall healthcare institutions' revenue in China. Based on the 2009 statistics from the MOH, we estimate the average annual revenue of a class-one / non-classified hospital was only circa CNY10mn, which is only one fifth the amount of the average CNY50mn for class-two hospitals or 4% the amount of the average CNY250mn for class-three hospitals.

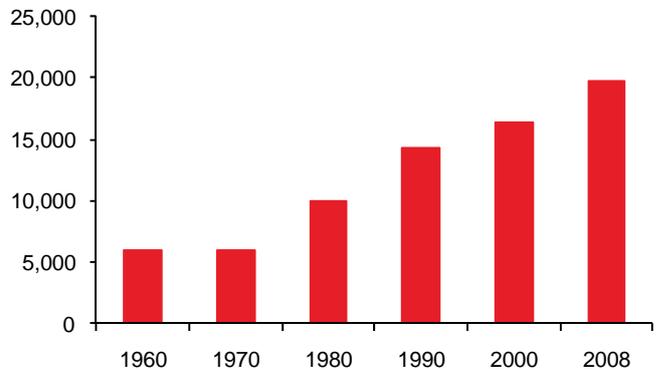
Hospitals have been growing strongly

**Fig. 26: China – number of health institutions**



Source: China National Health Yearbook (2009)

**Fig. 27: China – number of hospitals**



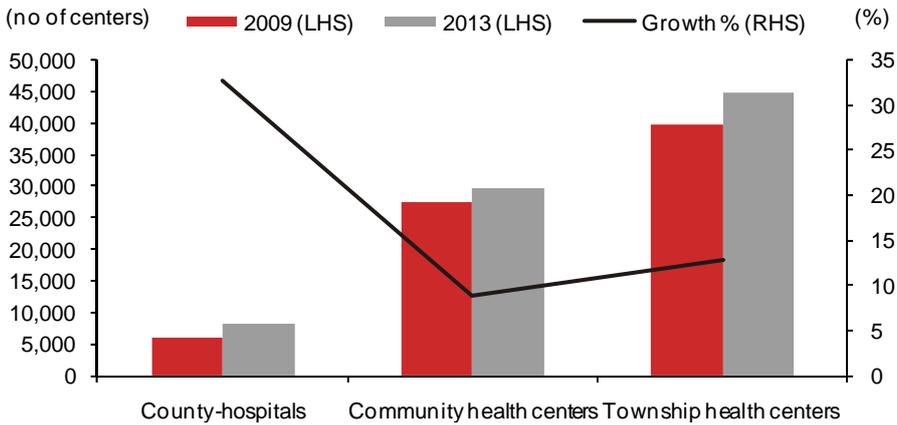
Source: China National Health Yearbook (2009)

At the bottom of the healthcare system are many thousands of basic healthcare institutions, comprising mainly the 27,000-plus community health centres, 39,000 township health centres and a large number of clinics, maternal and child care centres and diseases control centres. The annual budgets of some of these basic healthcare institutions are very limited and some are in remote and poor regions.

**Opportunities in county-level hospitals**

Reform of the public hospital system is one of the major policy targets of ongoing healthcare reform in China.

**Fig. 28: China – Government building projects for county hospitals and health centres**



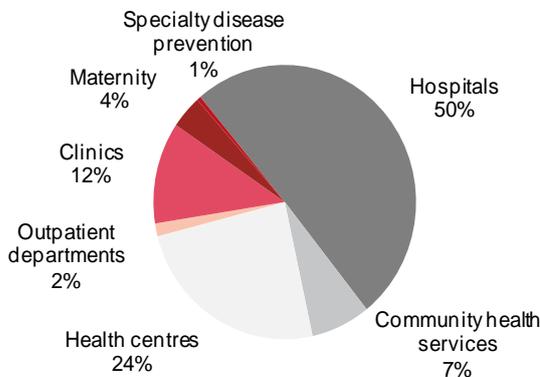
Source: MOH, Nomura research

To improve resource allocation and narrow the income gap between urban and rural regions, the central government has provided unparalleled financial support to county hospitals and health centres over the past few years, leading to higher growth in total revenues for state-owned county-level general hospitals than the total average state-owned general hospitals from 2005 to 2009.

China targets to invest approximately CNY850bn to reform the healthcare system from 2009 to 2011, of which about CNY100bn could be used to invest in the expansion of hospitals and basic healthcare institutions in rural areas. From 2009 to date, the central government has already invested CNY40bn to fulfill its target of building over 2,000 county hospitals, over 5,100 township health centres, over 2,400 community health centres and over 11,000 village clinics. Compared with the year-end number of institutions, we forecast the number of country-hospitals, township health centres and community health centres to increase by 33%, 9% and 13% by 2013. Current outpatient visits (a proxy for basic healthcare services) by medical institution are shown below.

China targets to invest cCNY850bn to reform the healthcare system from 2009 to 2011

**Fig. 29: China - Outpatient clinical visits by medical institution (2008A)**



Source: China National Health Yearbook (2009)

As MOH targets to spend a total CNY100bn for the completion of these building projects, we expect the remaining CNY60bn budget to be spent by end 2013. As a high proportion of this budget could be spent on the purchasing of high and low level medical equipment including gloves in the later building stage, we thus expect not less than 50% of the remaining CNY60bn budget could be spent on purchasing of medical equipment in 2011-13. Moreover, the Ministry of Finance has also set aside CNY13bn to help the healthcare institutions in counties, towns and villages to purchase basic medical equipment since 2009.

## Escalating government financial support – should lead to volume of growth in hospitals

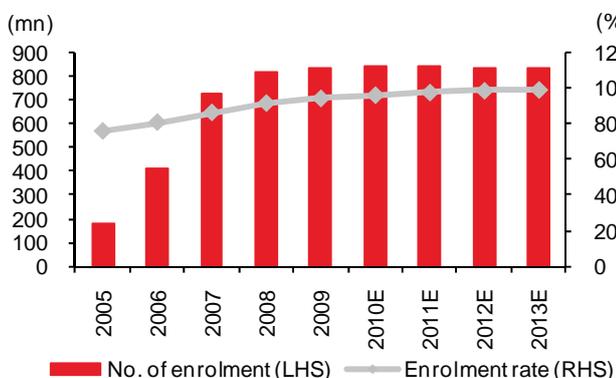
With the government’s strong commitment shown by healthcare reform launched in 2009, we see a reduction in the private payment percentage of total healthcare expenditure in the country. This is mainly due to the government’s escalating direct financial support to expand the national medical insurance coverage and increase in the minimum reimbursement ratio to lower people’s co-payment burden.

According to the MOH’s annual working report, the country’s national medical insurance coverage ratio substantially increased from 30% in 2005 to over 90% by the end of 2010. Currently, there are over 850mn people enrolled in the New Rural Cooperative Medical Scheme (NRCMS) and over 400mn people enrolled in the two urban Basic Medical Insurance Schemes (BMIS), compared with only 179mn and 138mn in 2005.

We note significant growth in coverage rates, and that the per capita direct annual subsidies from the government to NRCMS increased to CNY126 in 2010. Annual average per capita fund raising is targeted to increase to CNY200 in 2011 and to CNY300 in the 12th Five-Year Plan period. Moreover, the MOH reformed the payment mechanism to shorten the reimbursement period and reduce the cash flow burden to patients for hospitalization services.

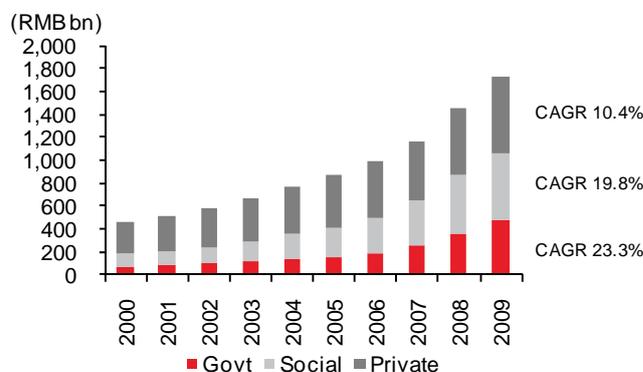
According to the MOH’s annual working report, the country’s national medical insurance coverage ratio has substantially increased from 30% in 2005 to over 90% by the end of 2010

**Fig. 30: Increase in coverage rate of two Basic Medical Insurance Schemes**



Source: MOH, Nomura estimates

**Fig. 31: China’s healthcare expenditure breakdown by contributors**



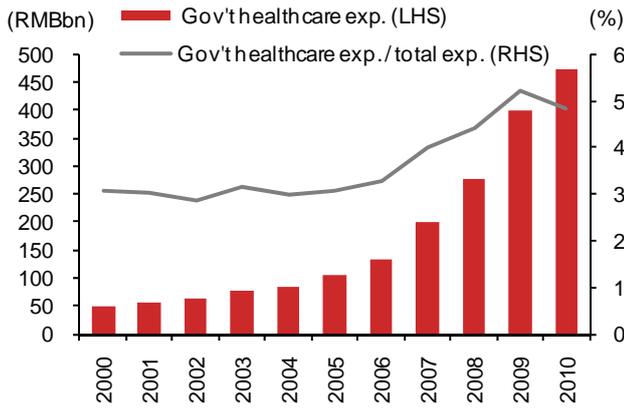
Source: MOH, Nomura estimates

Given the divergent financial position of different regions in China, the in-patient reimbursement ratio and maximum limit is generally lower in the rural and inland regions than in the urban and coastal regions. As a result, the relatively poor need to bear a higher co-payment burden than insured employees in urban areas. The actual reimbursement ratio is generally less than 50% for the farmers in NRCMS compared with 70% for enrolled employees under BMIS.

Given the co-payment burden of 30-50% of the total in-patient cost, some members of the general public have not been able to afford costly treatment and surgery. With the increase in direct government subsidies, many local and provincial governments have started to increase the reimbursement ratio and lifted the maximum reimbursement amount for major and chronic diseases. According to the MOH, the in-patient service reimbursement ratio has increased by 5ppt and the maximum reimbursement limit increased to six times a farmer’s average annual income in 2010.

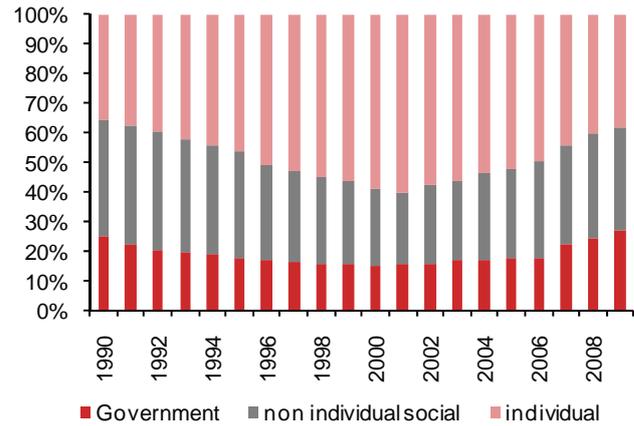
For 2011, we expect the market to benefit from the following major policy targets of the NDRC and MOH: 1) the increase of two BMIS coverage ratios to over 90%; 2) increase in per capital contribution in NRCMS to CNY200 a year; 3) increase in minimum reimbursement ratio for in-patient treatment of not less than 70%; and 4) increase in the maximum reimbursement amount equivalent to about 6x the average annual salary/disposal income/ farmer income in the respective cities or counties. All this should lead to volume growth in Chinese hospitals.

**Fig. 32: Government's healthcare expenditure and as % of total expenditure**



Source: CEIC, Nomura research

**Fig. 33: Reduction in individual expenditure as % of total healthcare expenditure**

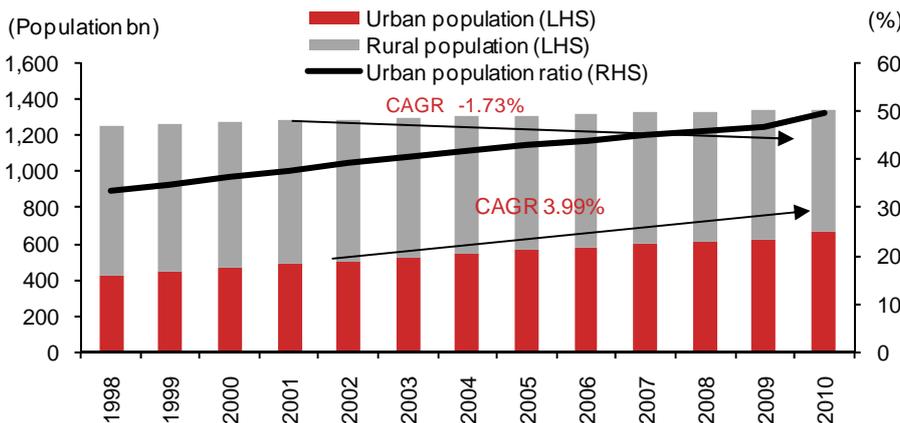


Source: CEIC, Nomura research

**Intact long-term supportive economic and demographic trend**

After consecutive years of rapid growth, China still has a very positive economic trend and demographic structure to support the long-term high growth of the country's medical device industry and market over the next decade. These important macroeconomic growth drivers include the continuous process of urbanization, healthy GDP growth, increase in disposable income and an aging population.

**Fig. 34: Trend of urbanization in China**



Source: CEIC, Nomura research

China's growing urbanization is the key driver behind the GDP growth and increase in disposable income, which in turn supports the industry upgrade of the medical market in China. We note a solid trend of urbanization in China, with its urban population rising at c4% CAGR from c33% of total population in 1998 to c50% in 2010. The urban population is likely to increase to over 60% of the total population by the end of 2020, based on the current trend of development.

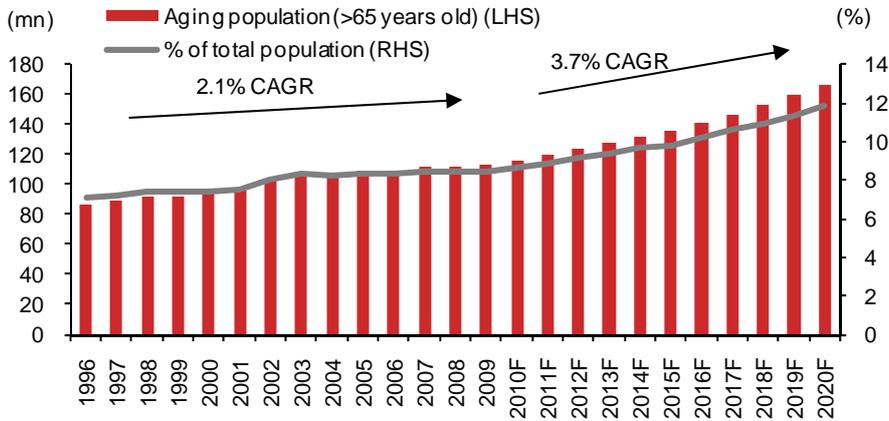
With over 660mn people living in urban areas, we see rapid growth for the middle class in China, with rising disposable income. This will likely drive the change in higher spending patterns and rising demand for more medical services. Currently, the average reimbursement ratio remains higher in the large cities than the rural areas due to the different financial supports between different regions.

Urbanization, in our view, will continue to improve consumer disposable income and support volume growth of markets in China. We expect this trend to continue and believe this will be a positive for medical glove maker companies operating in China. In addition to urbanization, the aging population will be another strong long-term push for the fast growth of healthcare expenditure in China. At present, the nation has nearly 116mn

We note a solid trend of urbanization in China, with its urban population rising at c4% CAGR from c33% of total population in 1998 to c50% in 2010

people over 65 years of age, accounting for 8.6% of the population. China is expected to see its aging population grow faster in the next decades. According to a United Nations forecast, China's aging population is expected to increase at a 3.7% CAGR to more than 166mn by 2020 (12% of total population), and then at a 3.3% CAGR to reach 230mn by 2030 (16.5% of total population).

**Fig. 35: Aging population growth to accelerate until 2030**



Source: CEIC, United Nations, Nomura estimates

## Conclusion

Based on the experience of developed countries, average healthcare expenditures and visits to hospitals of an older population group are about five times those of the non-aging population. We expect more aged people means an increase in the prevalence of many diseases, and this should be a long-term sustainable growth driver for the healthcare industry in China, given the higher rate of hospitalization for older people. We also expect improving hospital affordability among China's aging population, due to the government's increase in the medical insurance reimbursement ratio for the retired and aging group.

We expect improving hospital affordability among China's aging population

# The current state of the Chinese glove market

*Medical glove use is relatively low amongst Chinese physicians, and should improve over the medium term, in our view.*

The primary function of gloves is to provide a competent barrier to protect against infections for both healthcare professionals and the patients. Gloves used by healthcare workers need to be single-use for each patient contact and treatment, although it is recommended that prolonged and indiscriminate use should be avoided to minimize the risk of sensitization. They are required in various situations such as invasive procedures and contact with non-intact skin, mucous membranes or sterile sites. As such, leakage must be minimal, even when apparently undamaged, and various standards have been developed in order that all gloves perform adequately regardless of material. They should be easy to put on, comfortable to wear and provide adequate, durable protection.

### Chinese doctors don't use gloves to the same extent as in other countries

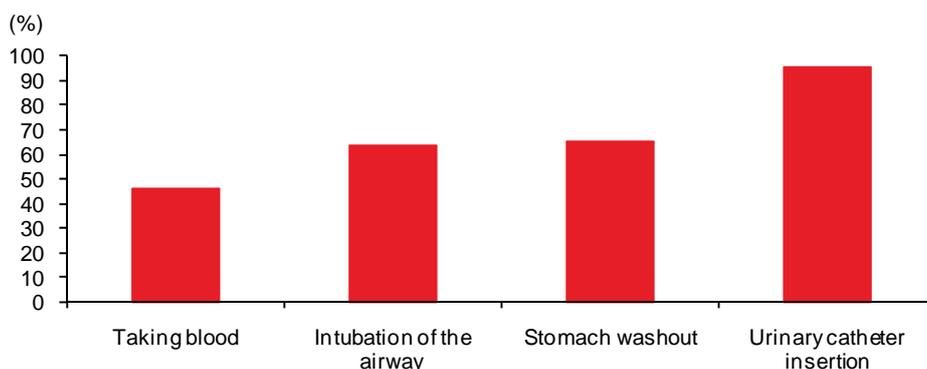
By some estimates, >70% of the health care visits in China occur at village-level clinics. These clinics are staffed by village-level rural doctors and doctors of traditional medicine.

There have been significant improvements in raising the quality of healthcare personnel. However, quality has to be further enhanced to increase the level of patient care. Notably, there are challenges because no uniform definition exists to document the required qualifications of healthcare personnel. In addition, current training and experience of healthcare personnel is relatively weak. The inconsistent and low quality of healthcare workers is a particular issue in rural areas. A 2001 study of 46 counties and 781 village doctors in 9 Western provinces found that 70% of village doctors had no more than a high school education, and had received an average of only 20 months of medical training. Not only are there fewer personnel in rural areas, it is very difficult to attract and retain skilled personnel to work in less developed regions of China.

A cross-section of physicians from a large teaching hospital in Shijiazhuang City, Hebei Province has been studied. Of the respondents, 54.1% said they never wore protective gloves whilst taking blood samples. Regular glove usage during gastric lavage, endotracheal intubation and indwelling urinary catheter insertion or removal was reported to be 65.6%, 63.5% and 95.8%, respectively.

A large opportunity exists for the development of increased glove use via the education of Chinese doctors

**Fig. 36: Chinese doctors – use of gloves during certain medical procedures**



Source: PubMed

Overall, the study suggests that infection control practices may be suboptimal among Chinese physicians. Hence, a large opportunity exists for the development of increased glove use via the education of doctors of the importance of barrier protection and infection control through the use of gloves.

## The SARS/Bird flu epidemics – highlights the need for ongoing infection control in China

### Background to the epidemic

In 1978, China began fiscal decentralization from the national level to the provinces and from the provinces to the counties. The new approach of “every tub on its own bottom” shifted major financing for province-level government operations and services to the provinces themselves and substantially reduced centralized transfers. Unfunded mandates (directives and policies) are set at the level of the central government, but financing depends on local resources, allocation, and priority setting.

However, with privatization of the health care system that began in the early 1980s and the focus on economic investment in infrastructure and industry, local governments, especially poor ones, have greatly reduced investment in social sectors. Although the government owns health care facilities, government contributions for health at the local level are scant, and sometimes the only funds provided are for partial salary support, with nothing allocated for public health programs. As a result, the focus of the delivery of health care services in China is almost exclusively on the provision of curative services. User payment as a percentage of health care spending has been rising steadily for 20 years, from 20% to 54%.

The SARS outbreak of 2003 raised the need for a better national disease prevention and surveillance system. The central government has allocated CNY2.9bn (USD350mn) to help every province, city and county set up its own disease control and prevention centre. Since 2002, the government has allocated most of its additional funding to rural areas. Some initiatives include allocating special funds to Central and Western China, and funding graduates of medical colleges to serve in rural hospitals for one or two years.

All in all, the severe acute respiratory syndrome crisis exposed deficiencies in China's public health system. The threat of an avian influenza pandemic began with the severe acute respiratory syndrome (SARS) epidemic. The government is attempting to address this, but should there be another outbreak of avian flu, this would likely lead to increased use of glove as a part of infection control measures.

The SARS outbreak of 2003 raised the need for a better national disease prevention and surveillance system

## Will there be a move to NRL from vinyl gloves in China?

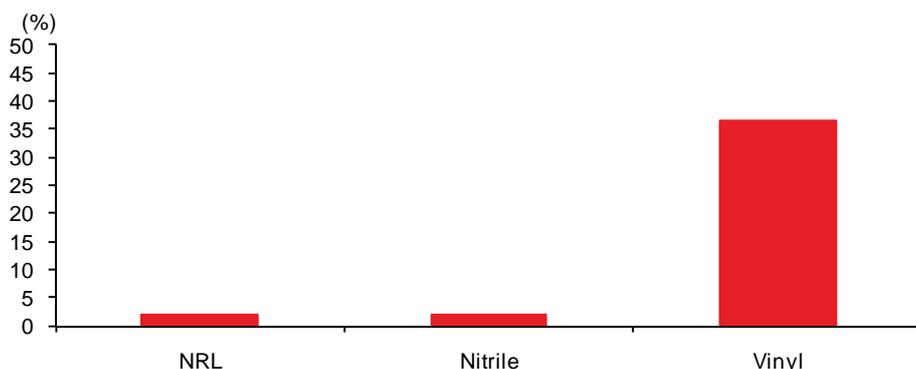
The global market size of PVC gloves is estimated at 90bn pcs per annum. We believe Chinese examination glove use is predominantly vinyl gloves. Major vinyl or PVC glove competitors include Rubberex, Precious Mountain, Hong Ray and Top Glove, all of which manufacture in China. Almost all PVC glove lines are in China due to the availability of cheap coal, resins and plasticiser in China.

That said, at present, global consumption of latex gloves is 150bn pcs of gloves pa. China's latex glove output is only about 4bn pcs a year, and China's latex glove export volume is less than 25% of Malaysia's export volume and accounts for less than 10% of the international market. Malaysia is currently the world's largest producer and exporter of latex gloves and has a latex glove capacity of more than 80bn pcs a year. Southeast Asian countries such as Vietnam, Thailand and Indonesia have large tracts of rubber tree plantations. The total latex glove export volume of Vietnam, Thailand and Indonesia accounts for about 10-12% of the international market.

Latex gloves (made by the Malaysian and Australian glovemakers) have preferable fit and comfort relative to the vinyl (made by local China suppliers) equivalent. Many factors are involved in the choice of materials for the production of medical gloves, which relate to both the protective effect as well as ease and comfort of use. For a large number of global healthcare practitioners, we believe NRL continues to be the glove material of choice.

We believe Chinese examination glove use is predominantly vinyl gloves

**Fig. 37: Average failure rate – various glove types**



Source: PubMed

The durability of barrier protection has been examined in a number of studies and it has been shown that NRL gloves provide lower rates of perforation and lower viral leakage rates than vinyl gloves. In a study that examined gloves after manipulation to simulate in-use conditions, the failure rate was 0–4% for NRL, 1–3% for nitrile and 12–61% for vinyl gloves, indicating better barrier protection by NRL and nitrile gloves, compared to vinyl. In another study where gloves were stressed according to a designated protocol before examining for leakage properties, failure rates were 2.2% for NRL and 1.3% for nitrile gloves, which were again better than for vinyl or copolymer (8.2% for each). Barrier integrity following an abrasion test demonstrated that NRL gloves were better than vinyl, although not as good as either nitrile or neoprene.

It has been shown that NRL gloves provide lower rates of perforation and lower viral leakage rates than vinyl gloves

**Fig. 38: Failure rates – NRL vs. vinyl gloves**

Author	Failure Rates (%)	
	Natural Rubber Latex	Vinyl
Korniewicz (1990)	7	63
Korniewicz (2002)	2.2	8.2
Klein (1990)	<1	22
	<1	56
Olsen (1993)	4.2 to 7.9	43
Douglas (1997)	1.1	25 to 32
		22 to 27
Rego (1997)	0-4	26 to 61
		12 to 20
Kerr (FDA) 2004	4 to 10	38
	9 to 17	33

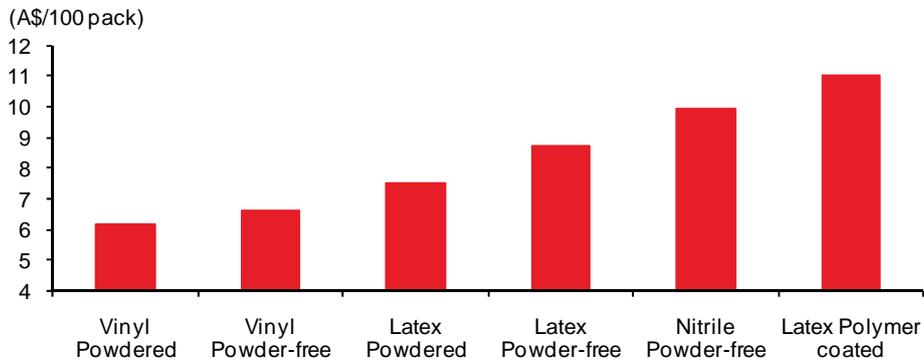
Source: PubMed

According to the Scientific Committee on Medicinal Products and Medical Devices of the European Commission, nitrile gloves are usually of lower tensile strength than latex gloves, but their elastic modulus, or stiffness, is somewhat higher. In addition, nitrile has a higher permanent set than latex, meaning that once stretched it does not fully recover. Thus, nitrile gloves tend to be designed to fit more loosely than latex, and the combination of these properties may affect the users' tactile sensation and delicacy of touch. This has been confirmed by a study where participants noted that nitrile gloves that fitted their fingers were too narrow for their hands and gloves that fitted their hands were too large for their fingers. During this research, it was confirmed that there are detectable differences between nitrile and latex, where a pegboard test demonstrated an 8.6% increase in fine finger dexterity for latex over nitrile, although no differences related to gross dexterity. Whilst it is not clear at present what the practical effects of this research mean, it does appear that the stiffness of nitrile may affect user dexterity. The study also questioned users about their preferred material, with 67% preferring latex and 21% preferring nitrile.

## Price differences between NRL and vinyl gloves

We believe there is the potential for the selling prices for latex gloves compared to vinyl glove to be an issue in the widespread adoption of latex glove use amongst Chinese healthcare professionals. However, as can be seen below, latex powdered gloves are c20% more expensive than vinyl powdered gloves. This combined with the lower failure rate for latex gloves, means that the value proposition for latex gloves is high when compared to vinyl gloves.

**Fig. 39: Retail price of different types of examination gloves (same brand)**



Source: Medshop

## Conclusion

Hence, we believe latent demand from China exists given a growing middle-income segment and increasing healthcare awareness. Currently, Malaysian and Australian glove players have little exposure to countries in the Asia region (some 6-10% exposure by sales).

This is despite a wealth of untapped demand for medical consumables forecast to come on-line over the next three years following healthcare reforms in India, China and Japan (please see the Nomura Healthcare report, *Asia-Pacific Anchor Report — Asia's vital signs*, 9 December, 2009). This has not been factored into our assumptions, and we believe increased demand from the region would be a source of positive upside for the Malaysian and Australian glove companies. Among the glove players, we see Top Glove as being the best positioned to benefit, since it already has two plants in China and 81% of its product mix comprises lower-end latex examination gloves targeted at developing markets.

Latex powdered gloves are c20% more expensive than vinyl powdered gloves

# Asian glovemakers already in China

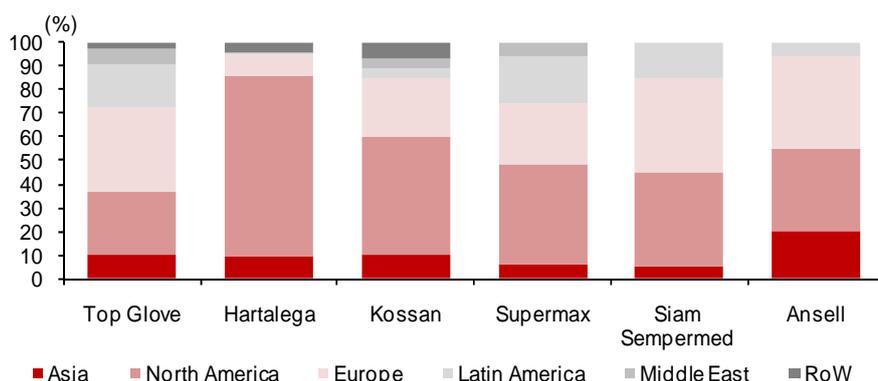
We believe Malaysian glove companies can capitalize on existing strong positioning should China market demand heat up.

## Malaysian glovemakers – Top Glove, Supermax, Kossan

Sales to Asia remain c10% of Malaysian glovemakers total glove sales, with sales to China estimated at no more than 5% of total sales. This is illustrated in the following figure. Although the lion's share of China's glove imports comes from Malaysia, in an absolute sense, China only imports roughly the equivalent amount as New Zealand does from Malaysia, implying scope for the Malaysian players to capitalize on their strong market share on any increased market demand. Some societal and language similarities between companies in these two countries allow Malaysian companies some form of advantage over other international peers.

Top Glove already has 2 factories in China

Fig. 40: Asian sales account for less than 10% of total sales for Malaysian glovemakers



\* Ansell data for whole company, data not available for medical glove division  
Source: Company data

The potential for increased demand from China has certainly not escaped the attention of most Malaysian glovemakers – Top Glove already has two factories in China (manufacturing mostly vinyl gloves), while Hartalega and Kossan have acquired stakes in trading and manufacturing companies incorporated in China and HK respectively.

On 26 May 2011, Hartalega acquired 70% of YanCheng Pharmatex Medical Equipment Co. Ltd., a trading company incorporated in China for cash consideration of MYR319,410. Hartalega acquired YanCheng to promote its own Pharmatex brand into China. Kossan, on the other hand, had in July 2011 completed its acquisition of a 51% stake in Cleanera (HK), a manufacturer of principally cleanroom products like masks, wipes and gloves.

Direct selling by foreign firms is not allowed, and foreign companies either need to sell via a local distributor, establish a JV with a Chinese company, or incorporate a local venture

Fig. 41: Currently, China imports few gloves

	Total glove imports (USD '000)	Imports from Malaysia (USD '000)	Malaysian market share (%)
Japan	38,782	22,507	58.0
Australia	13,267	9,917	74.7
Hong Kong	10,642	9,094	85.5
China	8,333	6,550	78.6
New Zealand	7,892	6,204	78.6
South Korea	10,571	5,940	56.2
Indonesia	5,472	4,746	86.7
Thailand	4,224	3,847	91.1
India	5,870	2,872	48.9
Philippines	3,785	2,026	53.5
Vietnam	1,355	1,154	85.2

Source: Espicom 2009 data

The main barrier to entry so far has been from a fairly fragmented and divided market where operating methods can differ from province to province – generally, direct selling by foreign firms is not allowed, and foreign companies either need to sell via a local distributor, establish a JV with a Chinese company, or incorporate a local venture. Top Glove has opted for the latter option, which allows the most management control and provides it experience in navigating the Chinese market.

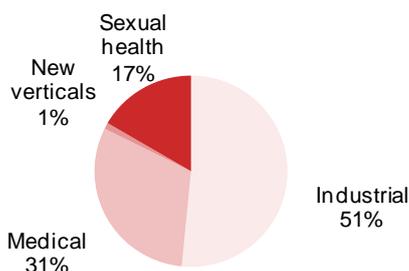
China only imports the same amount of exam gloves as New Zealand from Malaysia, despite the difference in population (1.3bn vs 4.5mn). This can be seen in the figure above.

## Ansell (ANN AU)

The most relevant division for ANN is ANN's Medical division

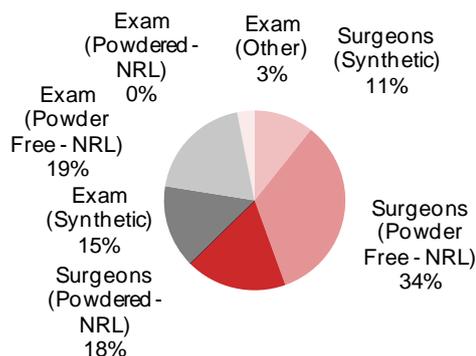
We enclose an outline of EBIT by product in ANN's medical division.

Fig. 42: ANN – FY12F EBIT by division



Source: Nomura estimates

Fig. 43: ANN Medical division – FY12F revenue by product



Source: Nomura estimates

Ansell Medical manufactures and markets a range of surgical and examination gloves. ANN has No. 1 global market share in surgical gloves and No. 2 market share in examination gloves. The last few years have witnessed a rapid expansion of the medical gloves market globally, as awareness increases of the benefits of gloves in providing effective protection. According to the US FDA, every year, 3mn of 35mn healthcare workers are exposed to blood-borne pathogens (Hepatitis B, C and HIV).

With the cancer diagnosis rate increasing exponentially (by 50% in 2020, according to WHO), more and more hazardous cytotoxics are being handled. In hospitals, healthcare professionals use:

- Standard and speciality surgical gloves;
- Examination gloves during various routine hospital procedures;
- Specialty gloves offering extra protection for cytotoxic handling; and
- In non-hospital settings, the same medical gloves are used by dentists, vets, independent nursing professionals, general practitioners and laboratory staff.

### Divisional strategy

ANN management have stated that they aim to continue to move this division into latex-free surgical gloves at the expense of latex examination gloves. ANN management believe that, given the strength of the surgical glove brands, their competitive advantage lies within the value-added surgical glove category.

### Outline of products

Major products in this division include: 1) Gammex surgical gloves – the highest-selling ANN product in the surgical glove category; 2) DermaPrene latex-free surgical gloves; 3) Encore latex-free surgical gloves – which are claimed to be easier for those surgeons and wearers who wish to double glove; 4) Medi-Grip – aimed at users in emerging countries; and 4) Micro-touch examination gloves.

ANN has No. 1 global market share in surgical gloves and No. 2 market share in examination gloves

# Could the Chinese glovemakers enter the NRL glove market?

*We believe it may be problematic for Chinese glovemakers to source and produce NRL and nitrile gloves in the short to medium term.*

## Issues with latex glove manufacturing in China

There are a number of issues with latex glove manufacturing in China. These include: 1) China's medical latex glove and examination latex glove industry production is scattered and is not conducive to centralized supply; 2) its product structure is single, dominated by powdered gloves, which need to be sterilized before use; 3) its output of powder-free, sterile and smooth medical gloves and examination gloves is relatively small and cannot meet domestic market demand; and 4) its product quality varies largely. In summary:

- Chinese manufacturers can't get access to the raw latex product, as optimal growing conditions are relatively rare in China compared to other Southeast Asian nations;
- Wet latex is expensive to transport and to store in China;
- Labour to produce gloves is cheaper in Malaysia and Thailand;
- Malaysian and Australian glove producers have scale, technical expertise and are further down the cost curve;
- There is the argument that Malaysian gloves are safer – based on an analysis of FDA glove import refusals data;

We explore this in more detail below, and begin this section with an explanation of how are gloves sourced and made with comments regarding potential difficulties for Chinese manufacturers to make latex gloves.

## Chinese glovemakers may find it difficult to produce NRL gloves

### Extraction of Natural Rubber Latex and the trees

NRL is produced when trees are tapped for latex by cutting a spiral groove in the bark and placing a spout and collection cup at the base.

### The rubber trees

The rubber tree is deciduous, losing all of its leaves in January during a hot dry spell. With the new leaves come the flowers, and then the fruit. The green fruit slowly turns brown. Because seeds rapidly lose their viability if exposed to sun and rain, the seeds are collected and put into a cold store or into a germination bed. The life cycle of a rubber tree is as follows:

- **Latex seed germination:** Seed germination takes 7-10 days.
- **Grafting the rubber tree:** When the seedling is 3 months old, using the standard grafting technique a small patch is removed from the seedling and a green bud is grafted on and bandaged.
- **Extraction of latex from trees:** This starts when the tree is 4-5 years old.
- **Development of tapping cycle:** Tappers generally change sides of the tree every 5 years. The rubber trees have a life span of 25-30 years.

The climatic conditions for optimum growth of rubber trees consist of: 1) rainfall of around 250cm evenly distributed without any marked dry season and with at least 100 rainy days per year; 2) temperature range of about 20°C to 34°C with a monthly mean of 25°C to 28°C; 3) high atmospheric humidity of around 80%, 4) bright sunshine amounting to about 2000 hours per year at the rate of 6 hours per day throughout the year; and 5) absence of strong winds.

Tapping is done early in the morning as long as it is not raining or the trees are not wet. Hence, in tropical areas, this is likely to occur approximately 100 days a year. A tapper can tap c500 trees in about 3 hours, and then collects the latex 4-5 hours after tapping.

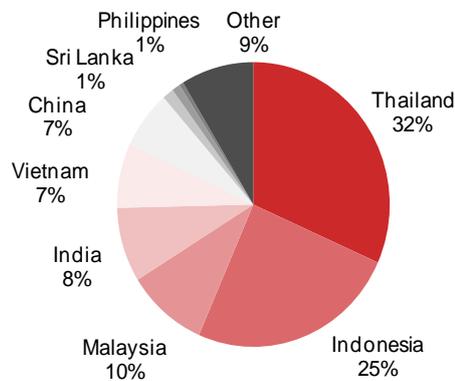
*We believe that given the climatic conditions in China, there is not the same geographic spread of areas suitable for the planting of rubber trees as in the rest of the Southeast Asia region*

After 4-5 hours post tapping, the latex vessels become blocked and the latex coagulates, leaving a white strip of latex on the tree. This is known as "Tree lace".

#### Nomura comment

We believe that given the climatic conditions in China, there is not the same geographic spread of areas suitable for the planting of rubber trees as in the rest of the Southeast Asian region. In addition, we believe the labour to collect the rubber sap is relatively cheaper in Thailand and Malaysia (the two largest producers of NRL) compared to Chinese labour. In summary, China produces 7% of total rubber produced in Asia, with the majority of rubber being used for products other than rubber.

**Fig. 44: Asian Producers of rubber (by volume) – 2010A**



Source: Association of Natural Rubber Producing Countries

#### Processing the rubber – production

When processing latex, the aim is to extract the rubber and leave the water and non-rubber components behind. Fresh latex coagulates fairly quickly.

Latex is generally either 1) processed into latex concentrate for manufacture of dipped goods or, 2) coagulated under controlled conditions using formic acid. Concentration is achieved by three methods:

- **Centrifugation:** This is the more common method. In both processes, the content of non-rubber components, including proteins, is reduced as the water is removed. This process is then carried out repeatedly;
- **Creaming:** in which case the rubber globules float to the top of a still liquid;
- **Evaporation:** in this method, non-rubber components are not removed. This method is hardly used nowadays. A large portion of the raw rubber is produced via coagulation. The non-rubber components are largely left behind in the aqueous phase and are removed further in the following stages of the process. The stabilized latex is concentrated to yield approximately 60% dry matter. Coagulation can be prevented by adding a stabilizer, generally ammonia. The latex thus kept in a liquid state can be processed at a later time.

Coagulated latex be processed into the higher-grade technically specified block rubbers such as TSR3L or TSRCV, or used to produce Ribbed Smoke Sheet grades. The dried material is then baled and palletized for shipment.

Naturally coagulated rubber is used in the manufacture of grade rubbers. The processing of the rubber for these grades is basically a size reduction and cleaning process to remove contamination and prepare the material for the final-stage drying.

#### Latex storage

Natural rubber latex concentrate is delivered to the consuming factory either in bulk, i.e. 9,000-14,000 litre tanker loads, or in 200 kg drums. Storage is important, as natural latex has the tendency to cream. When left undisturbed, the rubber particles move upwards and tend to concentrate at the surface. Therefore, the latex must be stirred by means of large diameter rotor blades at relative low speeds. The duration and frequency of stirring depends on temperature. The required storage tank capacity is clearly dependent on the consumption.

We believe it is relatively difficult to transport wet latex, and wet latex is required of optimal glove making

### Nomura comment

We believe it is relatively difficult to transport wet latex, and wet latex is required for optimal glove making. Should Chinese companies want to begin the manufacture of gloves, they will have to build manufacturing plants relatively close to the source of the latex, namely outside China. This would likely be a relatively large undertaking for a Chinese company. During the winter, heating costs would need to be factored into the cost base, while ASEAN nations are warm all year round.

Malaysia, Thailand and Indonesia are the top 3 rubber producers in the world; additionally they also enjoy fairly easy access to major ports (highlighted in red circles on the map).

**Fig. 45: Why ASEAN countries have an advantage in manufacturing vs China – location to raw material sources and accessibility**



Source: Google Maps, World Bank data, various news reports

### Production of gloves

Gloves are generally produced in very large numbers on highly automated production lines. Historically, this industry has used natural rubber latex since its ability to form smooth, continuous films on drying is advantageous, and its vulcanizates have high strength and elasticity.

In the dipping process, a suitably shaped form is immersed in a latex mix for an appropriate time and withdrawn to produce a uniform layer of latex on it. The latex deposit is then dried and vulcanised before the rubber product is removed from the former. Lattices concentrated by centrifugation to 60% dry rubber content are most commonly used. High-ammonia (HA) centrifuged concentrate and low-ammonia concentrate preserved with zinc oxide and tetramethylthiuramdisulfide (LA-TZ) are particularly used. Sulphur is used as the primary vulcanising agent with zinc oxide as activator and one or more accelerators.

A chain moves continuously around the top and bottom level of the dipping machine. Turning movable formers are connected to both sides of the chain. The formers can turn and also move up and downwards on the chain. The power transmission chain, as opposed to the conveyor chain common in dipping lines, gives smooth movement of the formers. The speed of the chain with the formers can be electronically adjusted. The

Given their experience, we believe Malaysian companies are further down the cost curve than a potential start-up Chinese glove company

formers pass several stations and at the end of the cycle stripping can be done manually or automatically. After being stripped, the formers are lowered into a weak acid solution, conveyed through and then withdrawn. The acid dissolves any deposits remaining on the formers.

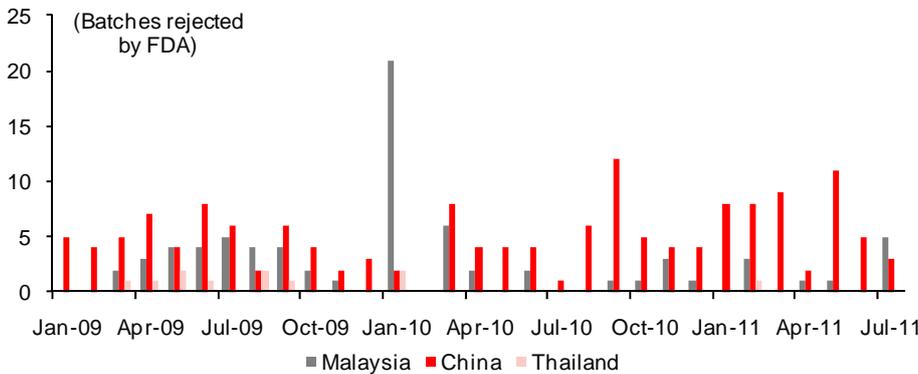
**Quality control**

For quality assurance, the products (for example, surgical gloves) will be inspected by lot when they are stripped. They will be classified by size, weight and batch number, and random samples will be taken from each lot. The gloves will be inflated, and a visual inspection performed for major/minor defects and cosmetic faults. A surgical glove is packed in a paper bag, left and right hand glove. This is done by an inner-wrapping machine. This bag with the pair of surgical gloves is put on a conveyor belt to the outer wrapping machine. After packing, the complete set is sterilised.

**Nomura comment**

Given their experience, we believe Malaysian companies are further down the cost curve than a potential start-up Chinese glove company would be. In addition, we believe that Malaysian-owned glove companies own proprietary glove making technology, which would again make it likely that they could make gloves faster and cheaper than their Chinese competitors. Finally, in terms of quality control, we believe that failure rates are higher for Chinese glove companies than for others. This makes it likely that a Malaysian glove manufacturer would be seen positively, even within the domestic Chinese market. FDA glove failure rates can be seen in the following exhibit.

**Fig. 46: FDA glove batch failure rates – sold into the US**

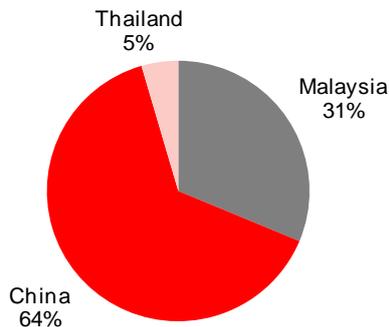


Source: FDA.gov

In terms of batches of gloves failed by the US FDA since January 2009, China has the majority of batch failures at 56%. This is shown in the following figure.

China has had the majority of batch failures at 56%

**Fig. 47: % FDA failure rates – China, Malaysia and Thailand (since 2009)**



Source: FDA.gov

**Latex allergy – unlikely to be an issue**

The amounts of protein (the cause of Type I allergic reactions) and various chemical additives (some of which may cause Type IV allergic reactions) vary throughout the

manufacturing process, and can be controlled by careful processing. The quantity of protein in a product made of natural rubber or natural rubber latex is highly dependent on the process being used. This ability to control the levels of latex protein is advantageous, as levels of latex protein are correlated with severity of latex allergy.

It has been demonstrated that a number of the many proteins present in natural rubber latex are capable of inducing type 1 allergy. Allergenicity varies from "no" to "high" per protein. Hypersensitivity to these proteins has increased considerably in the last 15 years. Figures that pertain to North America, as do most data published on this topic, show that less than 3% of hospital personnel and approximately 4% of dentists were hypersensitive to these types of proteins in 1980, whereas these figures had risen to nearly 17% and 30% by 1995.

Malaysia has introduced the Standard Malaysian Glove Program as a result. Developed in consultation with the Food and Drug Association (FDA) and other relevant authorities, the program ensures the manufacture of quality-assured latex gloves that provide maximum barrier protection and minimum latex-protein allergy risk.

### **Synthetic Rubber**

Synthetic rubber is a white material that can be processed and vulcanized in the same way as natural rubber latex.

Synthetic rubbers are artificially produced materials with properties similar to natural rubber. Most are obtained by polymerization or polycondensation of unsaturated monomers. A wide range of different synthetic rubbers have emerged, reflecting the various different applications and the chemical and mechanical properties they require. Co-polymerisation of different monomers allows the material properties to be varied across a wide range. Polymerisation can take place under hot or cold conditions, which result in hot polymers (hot rubber) or cold polymers (cold rubber).

Synthetic rubbers are marketed as compressed bales and square blocks. They are also produced in the form of powder rubber, talcum-coated chips, granules and as latex concentrates in liquid form. Synthetic rubber has better oil and temperature resistance and constant quality. The following list indicates some of the most important synthetic rubbers.

#### **Nitrile rubber**

Nitrile rubber (NBR) is a synthetic rubber copolymer of acrylonitrile (ACN) and butadiene. Although its physical and chemical properties vary depending on the polymer's composition of nitrile, this form of synthetic rubber is generally resistant to oil, fuel, and other chemicals. Nitrile butadiene is used to create moulded goods, footwear, adhesives, sealants, sponges, expanded foams, and floor mats. Its resilience makes NBR a useful material for disposable lab, cleaning, and examination gloves. Nitrile rubber is more resistant than natural rubber to oils and acids, but has inferior strength and flexibility. Nitrile gloves are nonetheless three times more puncture-resistant than natural rubber gloves.

#### **Isoprene**

Isoprene was first isolated by the thermal decomposition of natural rubber. It is most readily available industrially as a by-product of the thermal cracking of naphtha or oil, as a side product in the production of ethylene. About 95% of isoprene production is used to produce cis-1,4-polyisoprene—a synthetic version of natural rubber. Natural rubber is a polymer of isoprene, most often cis-1,4-polyisoprene. Typically, a small percentage of other materials, such as proteins, fatty acids, resins, and inorganic materials, are found in high-quality natural rubber.

In terms of batches of gloves failed by the US FDA since January 2009, China has the majority of batch failures at 56%

Synthetic rubbers are artificially produced materials with properties similar to natural rubber

## Could Chinese vinyl glovemakers switch to manufacturing NRL/nitrile gloves?

Whilst we believe the Chinese glovemakers (which predominantly make vinyl gloves) may find it difficult to switch to making NRL or nitrile gloves, we have analysed why these companies might see a switch as an attractive business opportunity.

This includes:

- **Access to capital:** We believe that access to capital might be relatively cheap at present in China, compared to some parts of Southeast Asia. Foreign capital tends to flow to economies that offer superior fundamentals, stronger growth potential and higher interest rates. China has been a favoured destination for hot money flows for years given its strong growth outlook, and will likely remain so in the future, placing continued strong appreciation pressure on the renminbi. In comparison to Australia, we believe it is relatively cheap to invest in factories in China.
- **Substantial growth in home market:** Given the low rates of glove use amongst medical professionals in China, we believe a large opportunity exists for substantial growth in glove use in the Chinese market;
- **Government protectionism in China:** We believe government protectionism in China is larger than in other Southeast Asian countries, as well as Australia.

### Who are the Chinese vinyl glovemakers?

We enclose a list of prominent vinyl glove producers in China below.

---

#### Fig. 48: Prominent vinyl glove producers - China

Batra Group China  
 Boen Healthcare  
 Dongguan Gaofu Clothes and Hats  
 Forte Medical Instruments  
 Hangzhou Flourishing Age Machinery & Tools  
 Hangzhou Pushi Industrial  
 Hospital & Homecare  
 Hubei Woohoo Healthcare  
 Hubei-Wuhan Light Industrial Products  
 Medtrue Enterprise  
 Qingdao New Oriental Car Accessories  
 Shanghai Wellkind Medical  
 Suqian Green Glove  
 Suzhou Industrial Park Winwin  
 Suzhou Sunmed  
 Top Glove (Zhangjiagang)  
 Wenzhou Pishon International Trade  
 Yiwu Tengsheng

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Source: Nomura research

Our examination of the latex glove market in China suggests that the latex glove suppliers in China are relatively new to the market. Examples of companies in the industry include: Qingdao Double Butterfly Group Co., Ltd., Shenyang Latex Products Factory, Shanghai Latex Products Factory, Guilin Latex Products Factory, and Beijing Latex Products Factory. Hence, given their experience, we believe Malaysian and Australian companies are further down the cost curve than a potential start-up Chinese glove company. In addition, we believe that Malaysian and Australian-owned glove companies own proprietary glove making technology, which would again make it likely that they could make gloves faster and cheaper than their Chinese competitors.

# Comparative company valuations

*Buy defensive distributors and manufacturers at trough valuations.*

Following the deterioration in macro outlook leading to possible market multiple compression in Malaysia, we have lowered our target prices for all the Malaysian glove manufacturers, but have increased our target price for ANN AU. This is upon imputing: 1) our revised (and stronger) MYR/USD assumptions; 2) the assumption that current latex prices do not correct into 2012 (although 2012 average prices will likely be below the highs reached in late 2010 and early 2011); and 3) downward revision of target P/E multiples for FY12F to reflect a weaker macroeconomic outlook and the corresponding impact on the overall market.

Most manufacturers have mostly delayed their expansions instead of scrapping them. We believe consolidation has a ways to go, as most major glove manufacturers still have healthy balance sheets and low gearing ratios, and remain unwilling to risk ceding market share should they be the first to completely halt expansions. We acknowledge, however, that EPS rebounds of 10-56% in 2012 will likely still be seen given the recent 10% easing in latex prices, despite our revenue growth assumptions remaining below average levels of <10%.

Despite the anticipated rebound in earnings, valuations for market leader **Top Glove** still appear unattractive in current capital markets conditions, in our view, trading at 13.8x FY12F revised forward earnings, at a premium to the Malaysian market. While operations appear to have stabilized, we think the current share price may still be expecting a much stronger rebound (versus our expectations of a few flat quarters ahead and lower visibility) – hence, we downgrade our rating to REDUCE from Neutral.

Top Glove is a REDUCE also given its unfavourable valuation despite our view of an earnings growth rebound into 2012, while visibility remains less certain as it still has a higher latex product mix than its peers.

ROEs are expected to remain lower than its other Malaysian-listed peers going into 2012 on lower growth and while it works on balancing out its product mix to increase exposure to nitrile gloves. The risk-reward picture is favourable for **Supermax** (BUY reiterated), as P/E valuations have corrected to single-digit valuations of upstream rubber names (which typically command lower multiples). Although **Kossan** is also at single-digit P/E valuations, it has the highest exposure to Western countries (c. 80%) versus peers, where minor consumables growth is forecast to moderate; hence our downgrade (from Buy to NEUTRAL). We expect ROEs to stay in the high teens into 2012, owing to a more balanced product mix and slightly better demand visibility.

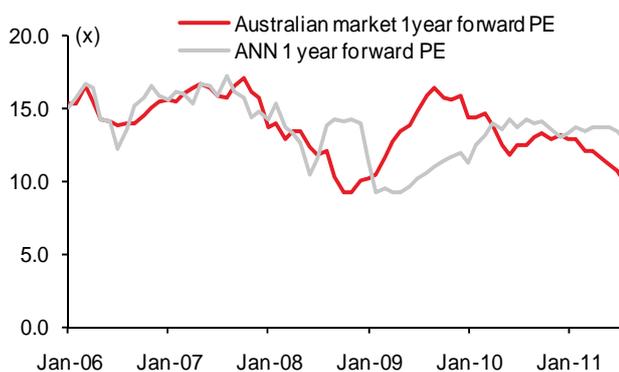
**Fig. 49: Change in key assumptions**

	2011F		2012F		2013F	
	old	new	old	new	old	new
RM / USD	3.3	2.90	3.3	2.77	na	2.68
Latex assumption (RM/kg)	8.5-8.8	9.2	8	8.5	na	7.5

Source: Nomura estimates

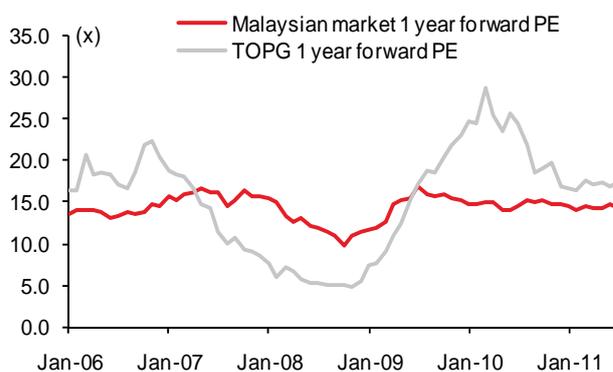
We enclose the Asian glovemakers 1 year forward P/E compared to their respective markets' 1 year forward P/E.

**Fig. 50: ANN: Discount to market**



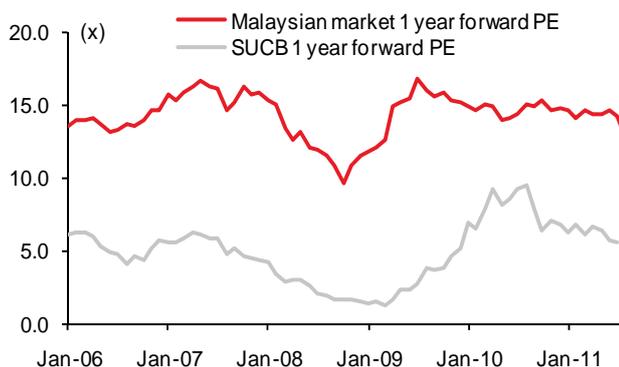
Source: Nomura estimates

**Fig. 51: TOPG: Discount to market**



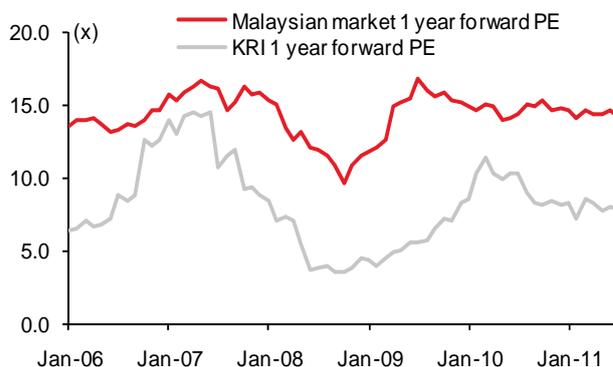
Source: Bloomberg, Nomura estimates

**Fig. 52: SUCB: Discount to market**



Source: Bloomberg, Nomura estimates

**Fig. 53: KRI: Discount to market**



Source: Bloomberg, Nomura estimates

**ANN – operates in a different part of the value chain**

Looking across the value chain, we believe that purchasers' bargaining power is stronger – benefiting major customers of the Malaysian OEM manufacturers such as Kimberley-Clark (KMB US, Not Rated), Cardinal Health (CAH US, Not Rated), and Ansell (ANN AU, Buy). Earnings are also less sensitive to fluctuations in rubber prices (for every 1% move in rubber prices, we calculate that the OEM manufacturers' earnings move between 5% and 6% whilst Ansell's moves by 1.1%) We upgrade our rating on Ansell to BUY from Neutral due to the earnings upgrade resulting from our lower FY12F latex price forecast.

For further details, please refer to the respective company sections within this report.

We believe that purchasers' bargaining power is stronger – benefiting major customers of the Malaysian OEM manufacturers

Fig. 54: Glovemaking comparables

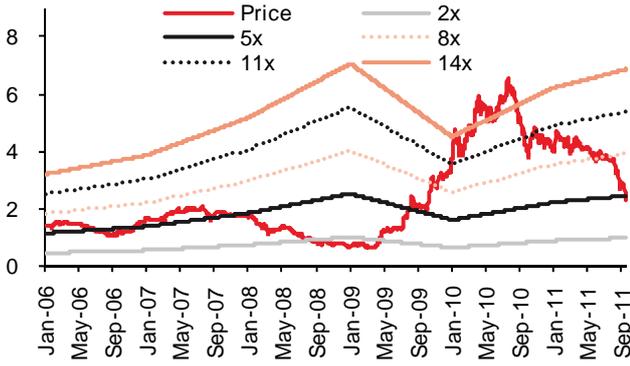
Companies	Ticker	Mkt cap (US\$m)	Curr.	Price (Loc)	Rating	ROE (%)		EPS growth (%)		P/BV (x)		P/E (x)	
						2011F	2012F	2011F	2012F	2011F	2012F	2011F	2012F
<b>Malaysia OEM glove manufacturers</b>													
Top Glove	TOPG MK	775	RM	4.00	REDUCE	10.9	15.6	-53.1	56.3	2.3	2.0	22.0	14.1
Supermax	SUCB MK	253	RM	2.37	BUY	14.8	17.8	-36.1	38.1	1.0	0.9	7.4	5.3
Kossan	KRI MK	261	RM	2.60	NEUTRAL	23.0	21.2	-1.8	10.2	1.6	1.3	7.4	6.7
Hartalega	HART MK	649	RM	5.69	NR	44.3	37.4	37.0	11.5	4.3	3.4	11.1	10.0
Latexx Partners	LTX MK	87	RM	1.25	NR	25.3	21.6	-15.0	3.3	na	na	4.2	4.0
Adventa	ADV MK	73	RM	1.53	NR	8.0	10.1	-45.8	42.3	1.0	0.9	11.8	8.3
<b>International Glove Brands</b>													
Ansell	ANN AU	1,730	AUD	12.99	BUY	19.3	19.7	15.0	19.4	2.4	2.4	14.0	12.6
Riverstone Holdings	SP	95	SGD	0.39	NR	18.6	19.5	-17.3	9.1	na	na	3.5	3.3
3M Company	MMM US	52,499	USD	74.0	NR	27.0	26.1	7.8	9.5	3.0	2.6	12.0	10.9
Honeywell Int'l	HON US	33,198	USD	42.4	NR	26.9	24.9	32.3	12.3	2.6	2.2	10.7	9.5
Reckitt Benckiser	RB LN	35,440	GBP	3,155	BUY	32.0	25.2	7.3	2.5	4.0	3.4	13.0	12.7
Kimberley-Clark Corp	KMB US	27,414	USD	70.0	NR	32.4	35.9	4.3	8.7	4.9	4.6	14.4	13.3
Cardinal Health	CAH US	14,377	USD	41.7	NR	17.2	18.1	20.3	18.8	2.7	2.3	15.6	13.2
Church & Dwight Co	CHD US	6,137	USD	42.8	NR	15.9	16.0	9.8	9.9	3.0	2.8	19.5	17.7
Semperit AG	SEM AV	813	EUR	29.4	NR	14.2	15.3	16.8	13.6	1.7	1.5	11.9	10.5
B&B Tools AB	BBTOB SS	213	SEK	52.0	NR	11.2	11.1	38.6	11.8	0.7	0.7	6.7	6.0
<b>Upstream</b>													
Sri Trang Agro	STA TB	813	THB	29.4	BUY	25.8%	19.6%	-17.3%	9.9%	1.8	1.5	9.2	8.4
GMG Global	GGL SP	213	SGD	52	NR	11.2%	11.1%	38.6%	11.8%	0.73	0.71	6.7	6.0

\* Priced as at 23 September 2011. NR = Not Rated. Note: ANN AU FY11 figures are based on actual reporting earnings

Source: Nomura, Bloomberg for non-rated stocks

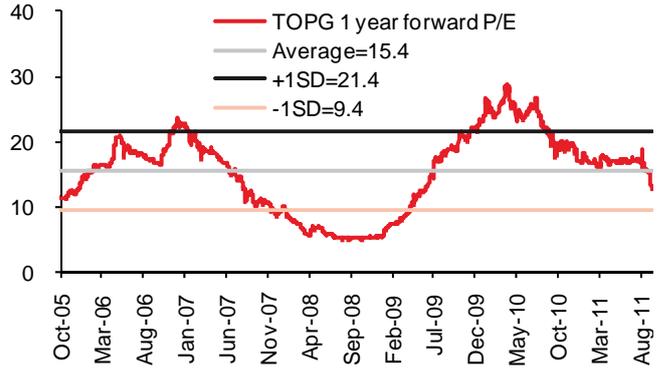
Next, we enclose P/E band charts for the Asian glovemakers in our coverage universe.

**Fig. 55: Top Glove – P/E Band**



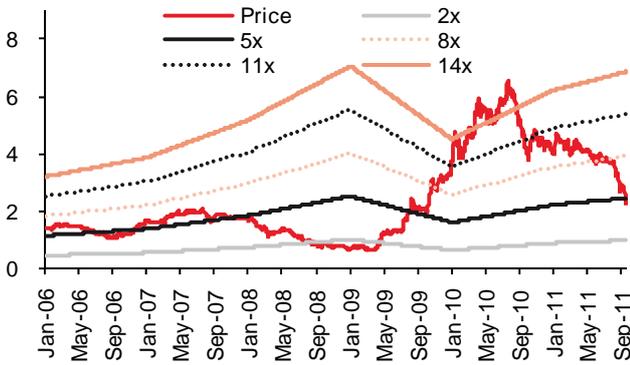
Source: Bloomberg, Nomura ^y-axis denotes share price in MYR

**Fig. 56: Top Glove – P/E Chart**



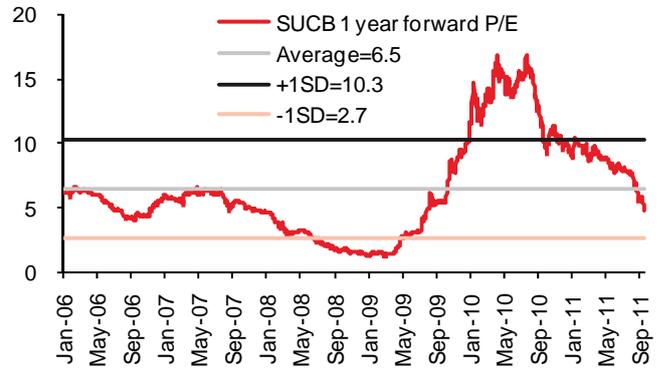
Source: Bloomberg, Nomura ^y-axis denotes multiple P/E multiple

**Fig. 57: Supermax – P/E Band**



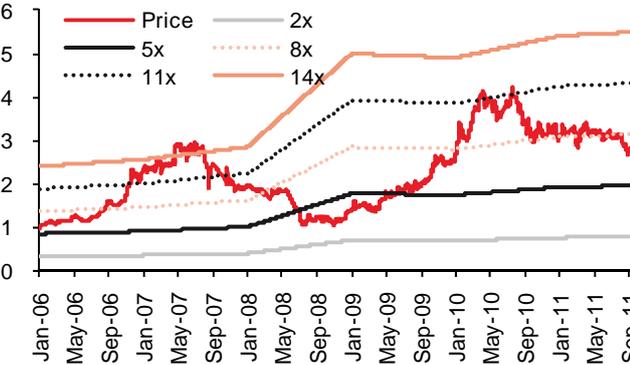
Source: Bloomberg, Nomura ^y-axis denotes share price in MYR

**Fig. 58: Supermax – P/E Chart**



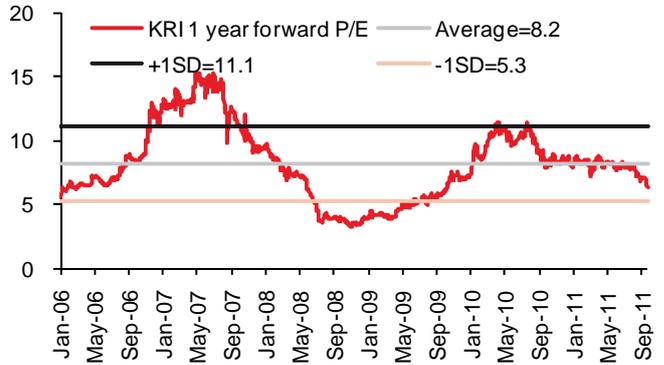
Source: Bloomberg, Nomura ^y-axis denotes multiple P/E multiple

**Fig. 59: Kossan – P/E Band**



Source: Bloomberg, Nomura ^y-axis denotes share price in MYR

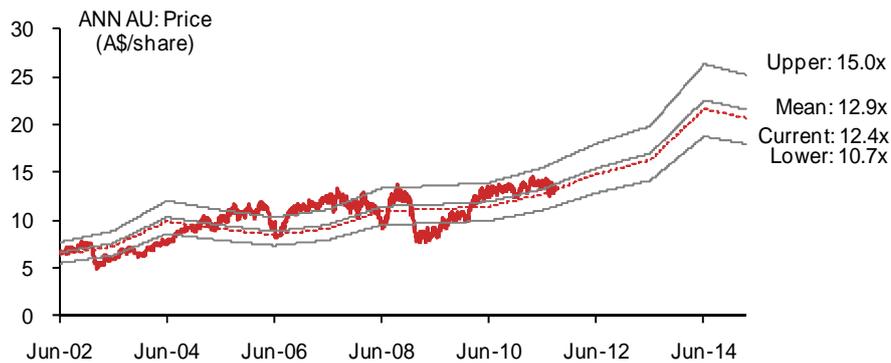
**Fig. 60: Kossan – P/E Chart**



Source: Bloomberg, Nomura ^y-axis denotes multiple P/E multiple

**Fig. 61: ANN: 12-month forward P/E multiple**

Based on actual EPS (12months forward)



Source: Nomura estimates, FactSet share price

**How does the 12-month forward P/E compare with historical levels?**

Using our new EPS assumptions, on a 12-month-forward P/E basis, ANN is trading at 12.4x. This is 4.1% below its mean 9-year historical 12-month-forward P/E of 12.9x.

**Summary of valuation methodologies**

- **Ansell** - We use a blend of three valuation methodologies to derive a valuation for ANN: these are discounted cashflow analysis (DCF), a capitalisation of EV/EBITDA, and normalised P/E multiples. We have also updated our healthcare comparables. As a result, our target price has increased by 5.5% to AUD15.25 (from AUD14.46).
- **Top Glove** - We peg our FY12E diluted EPS of MYR0.28 at 12x target multiple, below the stock's seven-year average of 15.6x owing to the current macro conditions, to arrive at a target price of MYR3.42.
- **Supermax** - We peg Supermax's target P/E at 6.5x from 11.5x previously following market multiple compressions. Applying this to FY12F EPS of MYR0.44, we derive our target price of MYR2.88.
- **Kossan** - We peg Kossan's target price to a 6.5x FY12F P/E multiple. Applied to our FY11F EPS of MYR0.39, we arrive at our target price of MYR2.51.

We enclose a review of each of the companies in our universe

**Summary of risks**

- **Ansell** - Upside risks include higher-than-expected volume growth driven by emerging market growth and an increase in industrial production activity; an announcement of further earnings-accretive acquisitions. Downside risks include pressure on costs from rising prices of raw material inputs; and a slowdown in the global economic recovery.
- **Top Glove** - Upside risks: 1) sharp easing of latex prices; 2) appreciable demand rebound from FY12E, and; 3) Top Glove making a value-enhancing acquisition.
- **Supermax** - Downside risks to our target price include industry-related factors similar to those facing Top Glove, as well as adverse and rapid currency movements that could affect income from the company's overseas distribution arms.
- **Kossan** - Potential downside to our view includes delays / hiccups to the new product launch, which could affect Kossan's strategy to gain market share from other nitrile players and the higher-end segment. Upside risks include sharp easing of latex prices and appreciable demand rebound from FY12F.

# Upgrade to BUY on easing cost pressure

## Easing latex prices leads to FY12F earnings upgrade

September 27, 2011

<b>Rating</b> Up from Neutral	<b>Buy</b>
<b>Target price</b> Increased from 14.46	AUD 15.25
<b>Closing price</b> September 23, 2011	AUD 12.99
<b>Potential upside</b>	+17.4%

### Action: We forecast NRL cost headwind to ease in FY12F

The natural rubber latex (NRL) price has fallen by 20% since April. Given NRL accounted for c.18% of FY11A group cost of sales, ANN has significant earnings leverage to movements in the NRL price. We estimate ANN's FY12 earnings sensitivity at +AUD1.6mn for a 1% decrease in the annual average NRL price. In this note, we adopt Nomura's new FY12F NRL house price forecast of MYR8.50/wet kg, leading to earnings uplift.

### Catalyst: Differentiated forecasts compared with guidance

Our new forecasts deviate from the company's guidance for FY12F EPS of USD0.97-1.03, which includes a deferred tax asset adjustment of USD0.07-0.10 per share (vs. Nomura at USD1.09). We note ANN's guidance 1) excludes its USD65mn share buyback, and 2) assumes that latex prices will increase in FY12F.

### Changes to forecasts: FY12F and FY13F EPS rises by 6.2% and 6.4%

We have reduced our FY12F NRL forecast to MYR8.50/wet kg, from MYR9.29/wet kg, and increased our FY12F nitrile forecast to USD2,600/MT from USD2,460/MT, in line with market movements. While we've made no change to our revenue forecasts, the impact of changes to raw material costs has increased our EPS forecasts by 6.2% for FY12 and by 6.4% for FY13.

### Valuation: TP rises to AUD15.25; upgrade to BUY rating

We have updated our healthcare comparables. As a result, our target price rises by 5.5% to AUD15.25. Using our new EPS assumptions, on a 12-month-forward P/E basis, ANN is trading at 12.4x. This is 4.1% below its mean 9-year historical 12-month-forward P/E of 12.9x. Upgrade to BUY.

30 Jun	FY11	FY12F		FY13F		FY14F	
Currency (USD)	Actual	Old	New	Old	New	Old	New
<b>Revenue (mn)</b>	1,207	1,329	1,329	1,422	1,422	1,510	1,510
<b>Reported net profit (mn)</b>	122	135	143	152	161	166	177
<b>Normalised net profit (mn)</b>	122	135	143	152	161	166	177
<b>Normalised EPS</b>	91.64c	1.03	1.09	1.18	1.26	1.29	1.38
<b>Norm. EPS growth (%)</b>	15.0	12.4	19.4	14.8	15.0	9.4	10.0
<b>Norm. P/E (x)</b>	14.0	N/A	12.6	N/A	10.8	N/A	9.9
<b>EV/EBITDA (x)</b>	10.3	9.9	9.4	7.8	7.4	6.8	6.4
<b>Price/book (x)</b>	2.4	N/A	2.4	N/A	2.1	N/A	1.8
<b>Dividend yield (%)</b>	2.5	N/A	2.6	N/A	3.0	N/A	3.4
<b>ROE (%)</b>	19.3	18.7	19.7	19.3	20.3	18.6	19.6
<b>Net debt/equity (%)</b>	net cash	0.8	net cash				

Source: Nomura estimates

**Key company data:** See page 2 for company data and detailed price/index chart.

**Rating:** See report end for details of Nomura's rating system.

### Anchor themes

ANN has had a long history of new product development and strong market share, which we believe positions it well to continue to generate solid revenue growth.

### Nomura vs consensus

Relative to FactSet consensus estimates for normalised EPS, our ANN forecasts are above consensus by 8% for FY12F due to our forecasts for raw material inputs and the major currencies to which ANN is exposed.

### Research analysts

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See Appendix A-1 for analyst certification and important disclosures. Analysts employed by non US affiliates are not registered or qualified as research analysts with FINRA in the US.

# Key data on Ansell

## Income statement (USDmn)

Year-end 30 Jun	FY10	FY11	FY12F	FY13F	FY14F
<b>Revenue</b>	<b>1,086</b>	<b>1,207</b>	<b>1,329</b>	<b>1,422</b>	<b>1,510</b>
Cost of goods sold	-633	-734	-833	-899	-969
<b>Gross profit</b>	<b>454</b>	<b>473</b>	<b>496</b>	<b>523</b>	<b>541</b>
SG&A	-326	-336	-332	-337	-339
Employee share expense					
<b>Operating profit</b>	<b>127</b>	<b>137</b>	<b>164</b>	<b>186</b>	<b>203</b>
<b>EBITDA</b>	<b>150</b>	<b>159</b>	<b>188</b>	<b>224</b>	<b>242</b>
Depreciation	-20	-19	-21	-23	-24
Amortisation	-3	-3	-3	-15	-16
EBIT	127	137	164	186	203
Net interest expense	-9	-4	-3	-3	1
Associates & JCEs					
Other income	0	0	0	0	0
<b>Earnings before tax</b>	<b>119</b>	<b>133</b>	<b>161</b>	<b>184</b>	<b>204</b>
Income tax	-10	-8	-14	-18	-22
<b>Net profit after tax</b>	<b>109</b>	<b>125</b>	<b>146</b>	<b>165</b>	<b>182</b>
Minority interests	-3	-3	-4	-4	-5
Other items					
Preferred dividends					
<b>Normalised NPAT</b>	<b>106</b>	<b>122</b>	<b>143</b>	<b>161</b>	<b>177</b>
Extraordinary items	0	0	0	0	0
<b>Reported NPAT</b>	<b>106</b>	<b>122</b>	<b>143</b>	<b>161</b>	<b>177</b>
Dividends	-34	-40	-47	-53	-59
<b>Transfer to reserves</b>	<b>72</b>	<b>82</b>	<b>96</b>	<b>108</b>	<b>119</b>

## Valuation and ratio analysis

FD normalised P/E (x)	14.5	14.0	12.6	10.8	9.9
FD normalised P/E at price target (x)	17.0	16.5	14.8	12.7	11.6
Reported P/E (x)	14.4	14.0	12.6	10.8	9.9
Dividend yield (%)	2.3	2.5	2.6	3.0	3.4
Price/cashflow (x)	9.6	13.8	12.1	9.4	8.5
Price/book (x)	2.7	2.4	2.4	2.1	1.8
EV/EBITDA (x)	10.1	10.3	9.4	7.4	6.4
EV/EBIT (x)	11.9	11.9	10.8	8.9	7.6
Gross margin (%)	41.8	39.1	37.3	36.8	35.8
EBITDA margin (%)	13.8	13.2	14.2	15.7	16.0
EBIT margin (%)	11.7	11.3	12.4	13.1	13.4
Net margin (%)	9.8	10.1	10.7	11.3	11.7
Effective tax rate (%)	8.1	6.1	8.9	10.0	10.7
Dividend payout (%)	32.4	33.0	33.0	33.0	33.0
Capex to sales (%)	2.6	3.7	3.0	3.0	3.0
Capex to depreciation (x)	1.4	2.3	1.9	1.9	1.9
ROE (%)	20.1	19.3	19.7	20.3	19.6
ROA (pretax %)	14.6	14.1	15.3	16.5	17.5

## Growth (%)

Revenue	8.3	11.1	10.1	7.0	6.2
EBITDA	13.7	6.1	18.6	18.7	8.4
EBIT	18.6	7.5	20.0	13.4	8.8
Normalised EPS	20.2	15.0	19.4	15.0	10.0
Normalised FDEPS	20.8	15.9	19.4	15.0	10.0

## Per share

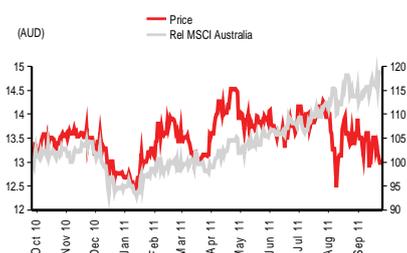
Reported EPS (USD)	79.69c	91.64c	1.09	1.26	1.38
Norm EPS (USD)	79.69c	91.64c	1.09	1.26	1.38
Fully diluted norm EPS (USD)	78.99c	91.57c	1.09	1.26	1.38
Book value per share (USD)	4.20	5.32	5.77	6.62	7.54
DPS (USD)	0.27	0.33	0.36	0.41	0.46

Source: Nomura estimates

## Notes

ANN guidance for FY12F EPS is USD0.97-USD1.03, including USD0.07- USD0.10 for DTA

## Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (AUD)	-2.8	-5.7	-0.5
Absolute (USD)	-10.3	-12.6	1.9
Relative to index	3.9	8.0	16.3
Market cap (USDmn)	1,614.7		
Estimated free float (%)	100.0		
52-week range (AUD)	14.7/11.82		
3-mth avg daily turnover (USDmn)	10.81		
Major shareholders (%)			
M&G Group	18.0		
Perpetual	6.6		

**Cashflow (USDmn)**

Year-end 30 Jun	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	150	159	188	224	242
Change in working capital	17	-7	-20	-13	-13
Other operating cashflow	-7	-28	-19	-24	-23
<b>Cashflow from operations</b>	<b>160</b>	<b>124</b>	<b>149</b>	<b>186</b>	<b>206</b>
Capital expenditure	-28	-45	-40	-43	-45
<b>Free cashflow</b>	<b>132</b>	<b>80</b>	<b>109</b>	<b>144</b>	<b>161</b>
Reduction in investments	0	0	0	0	0
Net acquisitions	-13	2	-14	0	0
Reduction in other LT assets	0	0	0	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments	0	0	0	0	0
<b>Cashflow after investing acts</b>	<b>118</b>	<b>81</b>	<b>96</b>	<b>144</b>	<b>161</b>
Cash dividends	-37	-42	-45	-50	-56
Equity issue	-45	4	-65	0	0
Debt issue	-63	-19	65	0	0
Convertible debt issue					
Others	7	35	0	0	0
<b>Cashflow from financial acts</b>	<b>-138</b>	<b>-22</b>	<b>-45</b>	<b>-50</b>	<b>-56</b>
<b>Net cashflow</b>	<b>-20</b>	<b>59</b>	<b>50</b>	<b>94</b>	<b>104</b>
Beginning cash	220	200	259	309	403
Ending cash	200	259	309	403	507
Ending net debt	49	-16	-1	-95	-200

Source: Nomura estimates

**Notes**

Our forecasts assume completion of 5mn share buyback for USD65mn

**Balance sheet (USDmn)**

As at 30 Jun	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	200	259	309	403	507
Marketable securities	0	0	0	0	0
Accounts receivable	165	193	212	227	241
Inventories	178	198	218	233	248
Other current assets	8	11	11	11	11
<b>Total current assets</b>	<b>551</b>	<b>660</b>	<b>750</b>	<b>874</b>	<b>1,007</b>
LT investments	0	0	0	0	0
Fixed assets	140	150	163	177	192
Goodwill	282	282	282	282	282
Other intangible assets	23	80	83	75	65
Other LT assets	107	125	139	139	139
<b>Total assets</b>	<b>1,102</b>	<b>1,298</b>	<b>1,417</b>	<b>1,546</b>	<b>1,685</b>
Short-term debt	48	198	211	211	211
Accounts payable	154	179	197	210	223
Other current liabilities	58	77	79	82	84
<b>Total current liabilities</b>	<b>260</b>	<b>453</b>	<b>486</b>	<b>503</b>	<b>518</b>
Long-term debt	201	45	97	97	97
Convertible debt					
Other LT liabilities	77	77	77	77	77
<b>Total liabilities</b>	<b>538</b>	<b>575</b>	<b>660</b>	<b>677</b>	<b>692</b>
Minority interest	12	15	18	22	27
Preferred stock	0	0	0	0	0
Common stock	756	954	889	889	889
Retained earnings	-176	-134	-38	70	189
Proposed dividends					
Other equity and reserves	-27	-112	-112	-112	-112
<b>Total shareholders' equity</b>	<b>553</b>	<b>709</b>	<b>739</b>	<b>847</b>	<b>966</b>
<b>Total equity &amp; liabilities</b>	<b>1,102</b>	<b>1,298</b>	<b>1,417</b>	<b>1,546</b>	<b>1,685</b>

**Notes**

ANN had a net cash balance in FY11

**Liquidity (x)**

Current ratio	2.12	1.46	1.54	1.74	1.94
Interest cover	14.8	34.2	47.1	74.4	na

**Leverage**

Net debt/EBITDA (x)	0.33	net cash	net cash	net cash	net cash
Net debt/equity (%)	8.9	net cash	net cash	net cash	net cash

**Activity (days)**

Days receivable	52.5	54.0	55.7	56.4	56.6
Days inventory	95.5	93.5	91.3	91.6	90.5
Days payable	77.1	82.7	82.4	82.6	81.7
Cash cycle	70.9	64.9	64.7	65.3	65.4

Source: Nomura estimates

## ANN – Upgrade to BUY

Over the past six months, the latex price has fallen by 20%. Although its latex exposure has declined over the last five years, Ansell still has significant earnings leverage to movements in the latex price. Our new latex forecasts have resulted in earnings and valuation upgrades. Accordingly, we have changed our rating from Neutral to BUY.

Over the past six months, the natural rubber latex (NRL) price has fallen by 18%. Given that NRL is the largest component of ANN's raw material costs and accounted for 18% of group cost of sales, the company has earnings leverage to movements in the NRL price. We estimate ANN's FY12 earnings sensitivity at +AUD1.6mn for a 1% decrease in NRL. Adoption of Nomura's house view on FY12F NRL forecast to MYR8.50/wet kg, from our previous forecast of MYR9.29/wet kg, has resulted in significant forecast earnings uplift. However, we have also increased our FY12F nitrile forecast to USD2,600/MT from our previous forecast of USD2,460/MT, in line with market movements, which has tempered the full impact of the potential earnings uplift from the lower NRL price.

While we have made no changes to our revenue forecasts, the impact of changes to raw material costs has increased our EPS forecasts by 6.2% for FY12 and by 6.4% for FY13. This is shown below. As a result of changes to our forecasts and updated health comparable multiples, our target price has increased by 5.5% to AUD15.25 (from AUD14.46), and we have changed our rating from Neutral to BUY.

Fig. 62: ANN: Changes to forecasts

	FY12F			FY13F			FY14F		
	Prev	Rev	Diff (%)	Prev	Rev	Diff (%)	Prev	Rev	Diff (%)
EBIT (US\$m)	154.1	164.2	6.6	174.8	186.2	6.5	190.0	202.5	6.6
NPAT (US\$m)	134.5	142.8	6.2	151.5	161.2	6.4	165.8	177.3	6.9
EPS (c)	103.0	109.4	6.2	118.3	125.8	6.4	129.5	138.4	6.9
DPS (c)	34.0	36.0	5.9	38.0	41.0	7.9	43.0	46.0	7.0
Net op cashflow (US\$m)	140.6	149.1	6.0	176.6	186.5	5.6	194.4	206.1	6.0

Source: Nomura estimates

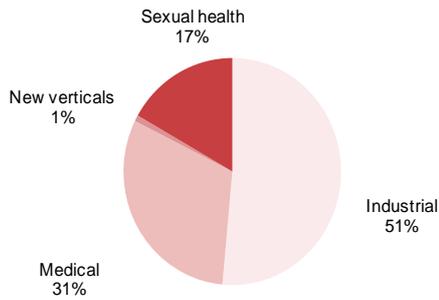
In this note, we

- Analyse the relationship between ANN's revenue growth in the Industrial division and global industrial production as it is a key earnings driver;
- Highlight Nomura's house view on the potential for global economic recovery;
- Update for recent movements in the natural rubber latex price; and
- Explain what this means for ANN.

### 1. Link between global industrial and employment growth and growth in ANN's Industrial division

Given the Industrial division's strong links to the auto, metal fabrication, and oil and gas industries, should evidence of a global recovery continue, then ANN has the potential to continue to realise solid revenue growth in those products that are used in these industries. Overall, the majority of ANN EBIT is derived from the Industrial division.

**Fig. 63: ANN – FY12F EBIT by division**



Source: Nomura estimates

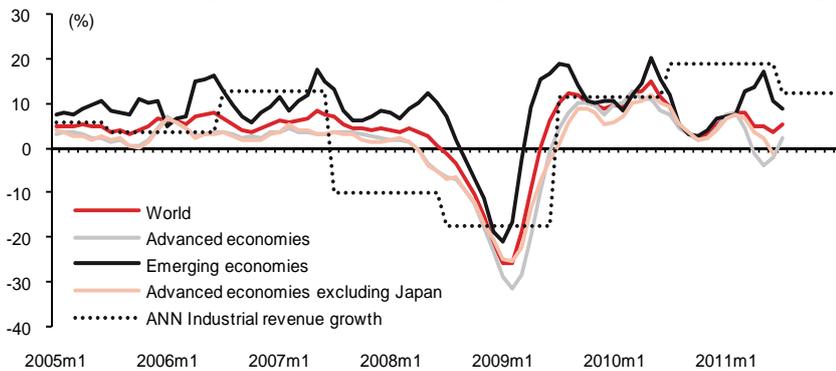
**IMF industrial production data**

We note that industrial production activity is a useful lead indicator for potential revenue growth in ANN's Industrial division. To that end, we have compiled the following chart using International Monetary Fund (IMF) industrial production data, using a three-month moving average. In addition, we overlay ANN's historical industrial division annual revenue growth for each fiscal year.

Industrial production activity is a useful lead indicator for ANN's industrial glove sales

**Fig. 64: Relationship of IMF production data to ANN industrial division revenue growth**

(Annualized percent change of three-month moving average over previous three-month moving average)



Source: IMF data, company data

We believe this analysis shows that, apart from the last result:

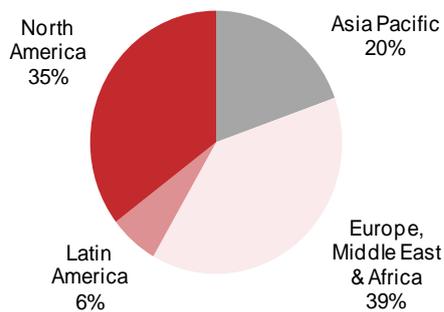
- **Relationship between industrial production and ANN industrial divisional growth:** ANN's industrial division revenue growth has tracked closely to industrial production. In our view, it also highlights a period of destocking in 2008.
- **Fledgling global economic recovery is underway, lead by China and Japan's recovery:** We believe economic recovery is underway in the advanced economies, albeit driven by Japan, and would argue that this will continue to underpin ANN's Industrial division's earnings over the medium term. Growth in emerging economies is forecast to be relatively strong, where Nomura expects an increase in manufacturing activity in response to low US inventory levels. Our economist's forecasts for China's industrial production are 14.1% in 2011F and at 13.9% in 2012F.

Recovery in industrial production activity since 2009 has also been reflected in ANN's FY10A and FY11A industrial revenue growth

## 2. Global economic viewpoints by Nomura's chief economist

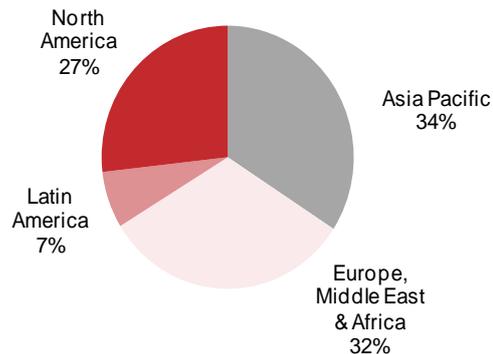
In FY11A, ANN generated 59% of its EBIT from North America and EMEA. Revenue and EBIT by geography are shown below.

Fig. 65: ANN – FY11A revenue by geography



Source: Company data

Fig. 66: ANN – FY11A EBIT by geography



Source: Company data

Given that ANN's business is exposed to several economies, we have compiled the global economic viewpoints of Nomura's chief economists for key regions.

### United States

- We expect the high level of household debt to restrain growth, as it has in recoveries after previous financial crises.
- Concerns about long-term deficits will make it difficult, but not impossible, to enact some of the president's proposed jobs bill.
- An erosion of confidence will likely suppress economic growth in 2H11.
- Ample unused capacity – evident in the high jobless rate – should restrain core inflation and contain inflation expectations.
- We expect the Fed in September to ease by changing the size and/or duration of its portfolio and by bolstering its "guidance."

### Europe

- We see the euro staying intact, with fiscal consolidation and debt restructuring, aided by official financing, restoring solvency.
- We expect euro-area activity to grow well below trend for the rest of 2011 before returning to just above trend growth in 2012.
- We expect a continued gradual recovery in UK growth despite the damping effect of deleveraging and fiscal consolidation.
- Inflation will likely stay over double the target during 2011 in the UK and peak about 1ppt above the 2% target in the euro area.
- We expect the ECB to delay its next rate hike until July 2012, and the BoE to delay its first hike until August 2012.

### Japan

- We expect a rapid recovery to continue, driven by reconstruction demand, with momentum tapering off in H2 2012.
- We expect a supplementary budget of JPY13trn to be passed in November, which should mitigate downside risks to growth.
- We expect the BOJ to increase its asset purchase program by a further JPY3-5trn in September 2011.
- The main risks relate to the nuclear plant and power shortages, a US/China slowdown and sharp appreciation of the yen.

### Asia ex Japan

- In a market meltdown Asia would be hit hard, save China and Indonesia, but the region should be the first to bounce back.

- China: We expect growth to remain strong, as the economy is increasingly driven by domestic demand.

### 3. NRL price pressure easing

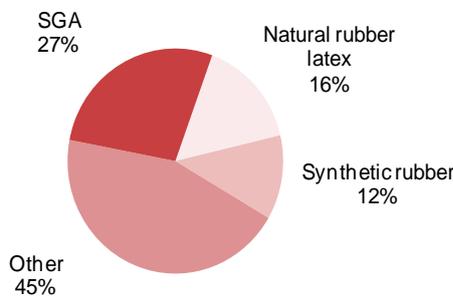
There are a number of raw material input costs for ANN, including NRL, synthetic rubber, cotton and polyester. According to ANN, raw materials account for approximately 35% of total cost of goods sold, with NRL accounting for the largest component of expenditure.

We believe that NRL has historically accounted for approximately 15% of ANN Group cost of sales. This figure can fluctuate by +/- 1% to 3%, subject to movements in the natural rubber latex price. In FY11A, we believe NRL was closer to 18% of cost of sales, given the NRL price was at a record high. As a result, ANN has significant leverage to movements in the NRL price, although the company's strategy is to actively move away from selling products where NRL is the main cost driver.

Approximately 43% of ANN's total revenue in FY11A was derived from products that use NRL albeit in varying degrees. This was down from 48% in FY08. The products with the largest reliance on NRL, where NRL accounts for more than 35% of COGS, are examination gloves and household gloves, which contributed circa 15% of total sales.

Raw materials account for approximately 35% of total cost of goods sold, with natural rubber latex accounting for the largest component of expenditure

**Fig. 67: Segment analysis of ANN's FY12F cost base**

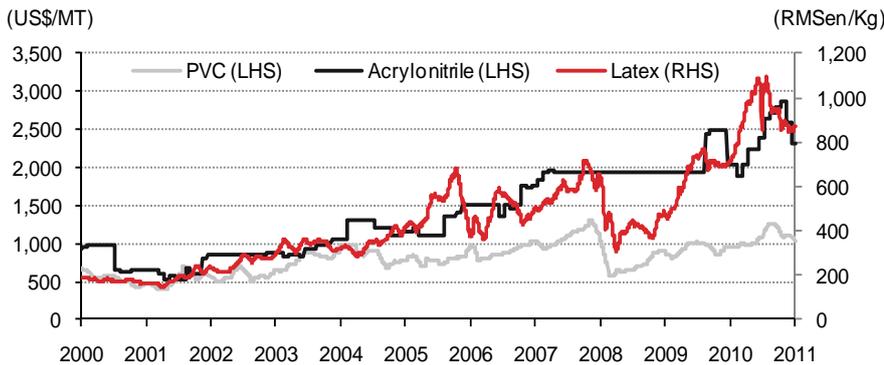


Source: Nomura estimates

The NRL price has increased by over 50% per annum over the past two financial years, acting as a significant headwind to ANN's earnings growth. This is shown in the following figure, where we illustrate the price of latex and components of synthetic rubber (PVC and acrylonitrile).

Average natural rubber latex prices have increased over 50% per annum over the past two years

**Fig. 68: Prices of latex, PVC and acrylonitrile**



Source: Datastream

We note that over the past two years, stock levels and exports declined, driving raw material prices to record highs. This was compounded by reviving automobile demand in China. Hence, we note that very low levels of stock may be an indicator of an impending rise in prices. NRL prices began to increase significantly in 2009.

Checks with glove players indicate no problems sourcing latex at the moment. Given this, we take the view that latex prices will likely fall from current highs as the market reacts to the latest data, but we flag that it will continue to be supported by expectations of good demand from China. Accordingly, Nomura's new house view for FY12F NRL price is forecast at MYR8.50/wet kg (average annual).

#### 4. What does this mean for ANN?

As a result of this analysis, we have not changed our revenue forecasts for ANN. Given the industrial division's strong links to the auto, metal fabrication and oil and gas industries, should evidence of a global recovery continue, then ANN is well positioned to continue to realise solid revenue growth in those products that are used in these industries. However we believe that there is the potential for earnings growth from any easing of NRL price pressure. We estimate ANN's FY12 earnings sensitivity at +AUD1.6mn for a 1% decrease in annual average price of NRL.

We believe that NRL currently accounts for approximately 18% of ANN's cost of sales

##### Changes to forecasts

We have adjusted our FY12 average latex price forecast to align with the Nomura house forecasts applied to the Malaysian glove makers. We had previously forecast 5% growth in annual average latex price of MYR9.29/wet kg. Our new forecast is for MYR8.50/wet kg, which reflects a 4% decline on pcp. This compares to the year-to-date actual figure of MYR8.69/wet kg. In addition, we have increased our FY12F average nitrile price to USD2,600/MT, up 11% on pcp (compared with 5% growth previously). This has tempered the extent of the potential earnings uplift from the lower latex price. As a result, our EPS forecast has increased by 6.2% for FY12 and by 6.4% for FY13.

##### Guidance conservative given global economic uncertainty

Our new forecasts are contrarian in that they deviate from the company's guidance that it provided at its FY11 results presentation last August 2011. ANN's guidance for FY12F EPS was USD0.97-1.03, which includes a deferred tax asset adjustment of USD0.07-0.10 per share (vs. Nomura at USD1.03). This implies FY12F EPS growth of 6-12% (vs. FY11 at 15% growth, which included an 8% input cost increase). We note company guidance 1) excludes the impact from its USD65mn share buyback, and 2) assumes that latex prices will increase in FY12F. We note our FY12F EPS forecast of USD1.09 includes completion of ANN's buyback.

#### Valuation methodology and risks

We use a blend of three valuation methodologies to derive a valuation for ANN: these are discounted cashflow analysis (DCF), a capitalisation of EV/EBITDA, and normalised P/E multiples. We have also updated our healthcare comparables. As a result, our target target has increased by 5.5% to AUD15.25 (from AUD14.46) and we upgrade our rating from Neutral to BUY.

Fig. 69: ANN: Valuation methodology

Metric	Weight (%)	Valuation (US\$ps)	Blended valuation (US\$ps)
DCF Valuation	33.3	15.85	5.28
P/E Valuation* at (14.9x FY12)	33.3	16.98	5.66
EV/EBITDA Valuation* at (10.7x FY12)	33.3	15.76	5.25
Blended Equity Valuation (US\$ps)	100.0		16.20
AUD/USD exchange rate			1.06
Price Target (A\$ps)			A\$15.25

\* P/E and EV/EBITDA multiples derived from average of comparable companies (from FactSet)

\*\* AUD target price is converted using the average forecast FY12F AUD/USD exchange rate

Source: Nomura estimates, FactSet consensus estimates

**Risks to our investment view**

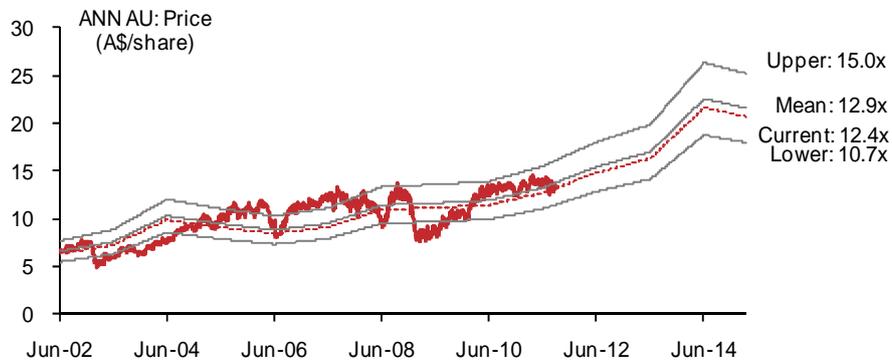
Upside risks include higher-than-expected volume growth driven by emerging market growth and an increase in industrial production activity; an announcement of further earnings-accretive acquisitions. Downside risks include pressure on costs from rising prices of raw material inputs; and a slowdown in the global economic recovery.

**How does the 12-month forward P/E compare with historical levels?**

Using our new EPS assumptions, on a 12-month-forward P/E basis, ANN is trading at 12.4x. This is 4.1% below its mean 9-year historical 12-month-forward P/E of 12.9x.

**Fig. 70: ANN: 12-month forward P/E multiple**

Based on actual EPS (12months forward)



Source: Nomura estimates, FactSet share price

## High utilisations, least earnings contractions Most exposed to developed nations

September 27, 2011

<b>Rating</b> Down from Buy	<b>Neutral</b>
<b>Target price</b> Reduced from 4.76	MYR 2.51
<b>Closing price</b> September 23, 2011	MYR 2.60
<b>Potential downside</b>	-3.5%

### Action/ Valuations: Cut target multiple on macro factors; Neutral

Adjusting for the macro conditions following market multiple compressions, our target multiple is now 6.5x (from 10x previously), slightly above its -1SD level given better earnings than the recessionary period of 2008. At 7.5x FY11F PE, the stock is trading at a discount of 43% to the market vs the 55% discount during August 2007-August 2009. Downgrade to Neutral.

### 2H11 should be sequentially better; however, the company with the lowest earnings contractions is likely to see less rebounds

Kossan's 1H earnings missed our and the Street's estimates by 15-20%, due to high latex prices and low overall demand. Revenue rose 7.5% y-y and q-q in 2Q on higher ASP. Kossan expects a better 2H with an additional 1.5-1.8bn pieces of new capacity in FY12 when its 2 new plants for nitrile and surgical gloves come onstream. We expect higher production utilisation in 2H due to the shutdown of 2 plants for revamping in 2Q. Amidst the industry headwinds, we forecast earnings will be almost flat in FY11F vs declines of 36% for Supermax and 53% Top Glove.

### Catalyst: Increased focus on achieving equal nitrile to natural rubber mix

2Q output was ~ 15% below its 2010 quarterly average of 2.35bn pieces per quarter with a nitrile-to-natural rubber mix of 57:43, which reached 49:50 in August. Kossan aims to have a nitrile-to-natural rubber mix of 50:50 by year-end. Nitrile, however, provides a margin buffer against unexpected costs increases. Given already high utilisation, we estimate 10% earnings growth in FY12F vs Supermax's 38% and Top Glove's 56%.

### Anchor themes

Easing costs are likely to remove earnings pressure on glovemakers; however; near-term demand visibility remains limited on continued capacity expansions. However, opportunities for new markets in the long-term exist, eg, China.

### Nomura vs consensus

Our FY11-12F earnings forecasts are in line with consensus

### Research analysts

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31 Dec	FY10	FY11F		FY12F		FY13F	
Currency (MYR)	Actual	Old	New	Old	New	Old	New
<b>Revenue (mn)</b>	1,047	1,206	1,298	1,268	1,478	1,506	
<b>Reported net profit (mn)</b>	114	152	112	155	124	126	
<b>Normalised net profit (mn)</b>	114	152	112	155	124	126	
<b>Normalised EPS</b>	35.70c	47.40c	35.06c	48.43c	38.65c	39.51c	
<b>Norm. EPS growth (%)</b>	75.0	34.0	-1.8	2.2	10.2	2.2	
<b>Norm. P/E (x)</b>	7.3	N/A	7.4	N/A	6.7	N/A	6.6
<b>EV/EBITDA (x)</b>	5.0	3.4	4.7	2.7	3.6	1.8	
<b>Price/book (x)</b>	1.9	N/A	1.6	N/A	1.3	N/A	1.1
<b>Dividend yield (%)</b>	2.8	N/A	2.7	N/A	3.0	N/A	3.1
<b>ROE (%)</b>	28.5	29.0	23.0	23.8	21.2	18.5	
<b>Net debt/equity (%)</b>	19.5	net cash	9.3	net cash	net cash	net cash	

Source: Nomura estimates

**Key company data:** See page 2 for company data and detailed price/index chart.

**Rating:** See report end for details of Nomura's rating system.

See Appendix A-1 for analyst certification and important disclosures. Analysts employed by non US affiliates are not registered or qualified as research analysts with FINRA in the US.

# Key data on Kossan Rubber Industries

## Income statement (MYRmn)

Year-end 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
<b>Revenue</b>	<b>842</b>	<b>1,047</b>	<b>1,298</b>	<b>1,478</b>	<b>1,506</b>
Cost of goods sold	-496	-659	-925	-1,066	-1,083
<b>Gross profit</b>	<b>346</b>	<b>388</b>	<b>373</b>	<b>412</b>	<b>423</b>
SG&A	-251	-240	-224	-235	-243
Employee share expense	0	0	0	0	0
<b>Operating profit</b>	<b>95</b>	<b>148</b>	<b>148</b>	<b>176</b>	<b>180</b>
<b>EBITDA</b>	<b>129</b>	<b>182</b>	<b>188</b>	<b>217</b>	<b>222</b>
Depreciation	-34	-34	-40	-41	-42
Amortisation	0	0	0	0	0
EBIT	95	148	148	176	180
Net interest expense	-9	-7	-10	-11	-11
Associates & JCEs	0	0	0	0	0
Other income	0	0	0	0	0
<b>Earnings before tax</b>	<b>86</b>	<b>141</b>	<b>138</b>	<b>165</b>	<b>169</b>
Income tax	-20	-27	-26	-41	-42
<b>Net profit after tax</b>	<b>66</b>	<b>114</b>	<b>112</b>	<b>124</b>	<b>126</b>
Minority interests	0	0	0	0	0
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
<b>Normalised NPAT</b>	<b>65</b>	<b>114</b>	<b>112</b>	<b>124</b>	<b>126</b>
Extraordinary items	-53	0	0	0	0
<b>Reported NPAT</b>	<b>12</b>	<b>114</b>	<b>112</b>	<b>124</b>	<b>126</b>
Dividends	-3	-23	-23	-25	-26
<b>Transfer to reserves</b>	<b>10</b>	<b>91</b>	<b>89</b>	<b>98</b>	<b>101</b>

## Valuation and ratio analysis

FD normalised P/E (x)	12.7	7.3	7.4	6.7	6.6
FD normalised P/E at price target (x)	12.3	7.0	7.2	6.5	6.4
Reported P/E (x)	67.8	7.3	7.4	6.7	6.6
Dividend yield (%)	0.3	2.8	2.7	3.0	3.1
Price/cashflow (x)	10.5	5.8	na	7.4	2.1
Price/book (x)	2.3	1.9	1.6	1.3	1.1
EV/EBITDA (x)	7.9	5.0	4.7	3.6	1.8
EV/EBIT (x)	10.7	6.2	5.9	4.5	2.3
Gross margin (%)	41.1	37.0	28.7	27.9	28.1
EBITDA margin (%)	15.3	17.4	14.5	14.7	14.8
EBIT margin (%)	11.3	14.1	11.4	11.9	12.0
Net margin (%)	1.5	10.9	8.6	8.4	8.4
Effective tax rate (%)	23.4	19.1	18.8	25.0	25.0
Dividend payout (%)	21.9	20.1	20.4	20.4	20.3
Capex to sales (%)	4.8	8.1	3.1	1.4	1.3
Capex to depreciation (x)	1.2	2.5	1.0	0.5	0.5
ROE (%)	3.7	28.5	23.0	21.2	18.5
ROA (pretax %)	14.6	21.8	20.1	22.0	30.8

## Growth (%)

Revenue	-6.1	24.3	24.0	13.9	1.8
EBITDA	19.2	41.4	3.5	15.5	2.2
EBIT	15.4	55.5	0.6	18.9	2.0
Normalised EPS	11.2	75.0	-1.8	10.2	2.2
Normalised FDEPS	11.2	75.0	-1.8	10.2	2.2

## Per share

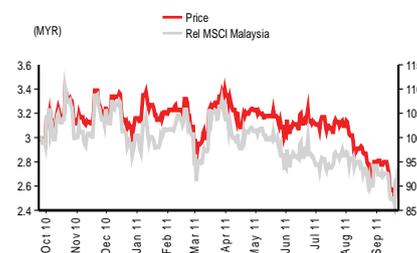
Reported EPS (MYR)	3.83c	35.70c	35.06c	38.65c	39.51c
Norm EPS (MYR)	20.40c	35.70c	35.06c	38.65c	39.51c
Fully diluted norm EPS (MYR)	20.40c	35.70c	35.06c	38.65c	39.51c
Book value per share (MYR)	1.12	1.38	1.66	1.98	2.30
DPS (MYR)	0.01	0.07	0.07	0.08	0.08

Source: Nomura estimates

## Notes

Given Kossan's already high utilisation and low demand visibility owing to high exposure to western countries, we estimate only 10% earnings growth in FY12F

## Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (MYR)	-6.5	-19.8	-13.3
Absolute (USD)	-12.6	-23.0	-15.3
Relative to index	0.9	-7.2	-7.7
Market cap (USDmn)	262.0		
Estimated free float (%)	44.0		
52-week range (MYR)	3.47/2.48		
3-mth avg daily turnover (USDmn)	0.21		
Major shareholders (%)			
Kossan Holdings Sdn Bhd	51.8		

**Cashflow (MYRmn)**

Year-end 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
EBITDA	129	182	188	217	222
Change in working capital	-67	50	-66	-30	258
Other operating cashflow	18	-90	-223	-75	-79
<b>Cashflow from operations</b>	<b>79</b>	<b>143</b>	<b>-101</b>	<b>112</b>	<b>401</b>
Capital expenditure	-41	-85	-40	-20	-20
<b>Free cashflow</b>	<b>39</b>	<b>57</b>	<b>-141</b>	<b>92</b>	<b>381</b>
Reduction in investments	0	0	0	0	0
Net acquisitions	4	46	0	0	0
Reduction in other LT assets	0	0	0	0	0
Addition in other LT liabilities	11	11	0	0	0
Adjustments	-11	-11	0	0	0
<b>Cashflow after investing acts</b>	<b>43</b>	<b>103</b>	<b>-141</b>	<b>92</b>	<b>381</b>
Cash dividends	-8	-14	-23	-23	-25
Equity issue	0	0	0	0	0
Debt issue	-32	-35	211	20	0
Convertible debt issue	0	0	0	0	0
Others	4	14	23	23	25
<b>Cashflow from financial acts</b>	<b>-36</b>	<b>-35</b>	<b>211</b>	<b>20</b>	<b>0</b>
<b>Net cashflow</b>	<b>8</b>	<b>68</b>	<b>70</b>	<b>112</b>	<b>381</b>
Beginning cash	16	24	92	161	273
Ending cash	23	92	161	273	654
Ending net debt	183	86	50	-42	-423

Source: Nomura estimates

**Notes**

We expect strong free cashflow from FY13F

**Balance sheet (MYRmn)**

As at 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
Cash & equivalents	24	92	161	273	654
Marketable securities	0	0	0	0	0
Accounts receivable	193	151	213	243	0
Inventories	110	124	182	192	0
Other current assets	1	1	1	1	1
<b>Total current assets</b>	<b>328</b>	<b>367</b>	<b>557</b>	<b>709</b>	<b>655</b>
LT investments	0	0	0	0	0
Fixed assets	359	410	396	375	353
Goodwill	1	1	1	1	1
Other intangible assets	0	0	0	0	0
Other LT assets	0	0	0	0	0
<b>Total assets</b>	<b>689</b>	<b>777</b>	<b>955</b>	<b>1,086</b>	<b>1,010</b>
Short-term debt	159	150	131	151	151
Accounts payable	97	113	168	178	0
Other current liabilities	4	10	10	10	10
<b>Total current liabilities</b>	<b>261</b>	<b>273</b>	<b>309</b>	<b>338</b>	<b>161</b>
Long-term debt	47	28	80	80	80
Convertible debt	0	0	0	0	0
Other LT liabilities	21	32	32	32	32
<b>Total liabilities</b>	<b>330</b>	<b>333</b>	<b>421</b>	<b>450</b>	<b>273</b>
Minority interest	2	2	2	2	2
Preferred stock	0	0	0	0	0
Common stock	80	160	160	160	160
Retained earnings	276	285	374	475	577
Proposed dividends	0	0	0	0	0
Other equity and reserves	1	-2	-2	-2	-2
<b>Total shareholders' equity</b>	<b>357</b>	<b>443</b>	<b>532</b>	<b>633</b>	<b>735</b>
<b>Total equity &amp; liabilities</b>	<b>689</b>	<b>777</b>	<b>955</b>	<b>1,086</b>	<b>1,010</b>

**Notes**

Solid balance sheet with net cash position expected from FY13F

**Liquidity (x)**

Current ratio	1.26	1.34	1.81	2.10	4.07
Interest cover	10.5	21.5	14.8	15.5	15.9

**Leverage**

Net debt/EBITDA (x)	1.43	0.47	0.26	net cash	net cash
Net debt/equity (%)	51.3	19.5	9.3	net cash	net cash

**Activity (days)**

Days receivable	76.8	60.0	51.2	56.5	29.5
Days inventory	81.7	64.7	60.3	64.2	32.4
Days payable	86.0	58.3	55.4	59.3	29.9
Cash cycle	72.5	66.3	56.0	61.4	31.9

Source: Nomura estimates

# Highest nitrile exposure, but most exposed to developed countries

So far in 2011, Kossan has experienced lesser earnings contractions than its peers (30% y-y in 2Q11 vs Top Glove's 60% and Supermax's 42%), owing to a higher nitrile glove mix (which has not seen as volatile cost increases as natural rubber latex this year). Kossan's earnings growth has also remained above 2008 recessionary levels.

Its capacity shift to nitrile gloves occurred long before the demand switch from natural latex gloves to nitrile ones, which was seen last year; Kossan has started branching into nitrile gloves since 2007.

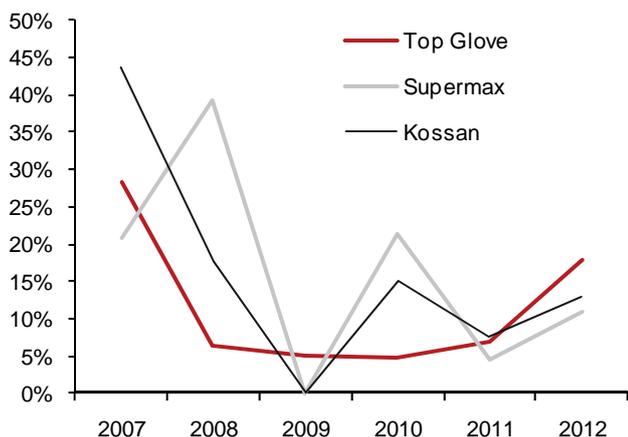
Kossan's capacity expansions continue to remain fairly within its peer ranges; it expects to add another 1.5-1.8bn pieces of capacity (translating into growth of 13% pa) via two new plants in 2012 to cater to nitrile and surgical glove production.

**Fig. 71: Shifted its production mix to nitrile since 2007**

	2007	2008	2009	2010	Current
Powdered Medical	25%	25%	15%	15%	10%
Powder free medical	57%	50%	50%	45%	40%
Nitrile Medical	18%	25%	35%	40%	50%

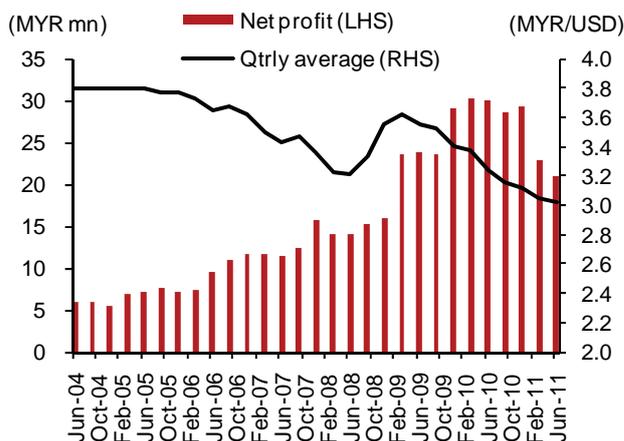
Source: Company data

**Fig. 72: Capacity expansion growth between Top Glove's and Supermax**



Source: Company data \*Data denotes y-y growth

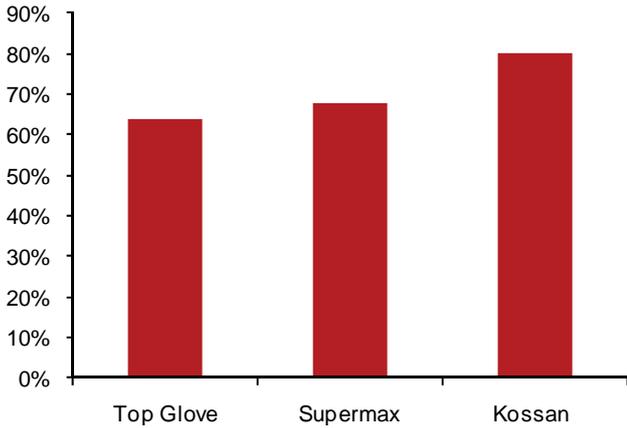
**Fig. 73: Earnings still above 2008 recessionary levels despite recent cost spikes**



Source: Company data, Bloomberg

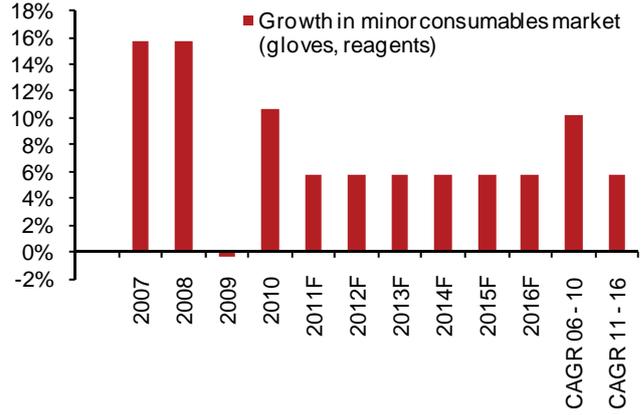
Despite a high nitrile mix, and the easing in natural latex costs to help drive an earnings rebound in 2012F, we expect lower demand visibility to affect players such as Kossan, as most major players have mostly deferred their capacity expansion plans to 2012. In addition, the company exports the bulk of its products to Western countries, where, despite better healthcare expenditures vs undeveloped countries, we expect growth in minor medical consumables to be moderate from over 10% CAGR historically to c. 6% over the next five years.

**Fig. 74: Comparison of exposure to Western developed countries**



Source: Respective companies' data

**Fig. 75: US market – minor consumables growth forecast to moderate**

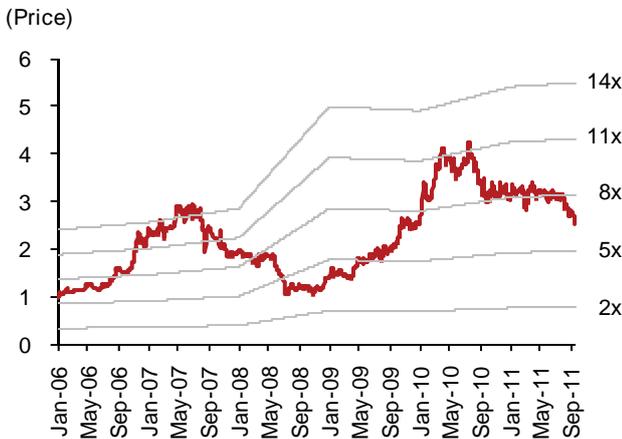


Source: Espicom

We think this (moderating growth expectations in minor medical consumables in Western countries) has not gone unrecognised by the company. In June 2011, it acquired a 51% stake in Cleanera (HK), a company specialising in cleanroom products to target the Chinese / Japanese markets representing its first direct presence in the Hong Kong market.

We adjust earnings to impute the average YTD latex price and introduce our revised latex forecast of MYR8.50/kg for 2012F. We also take into account our revised in-house MYR/USD estimates. Our revised FY12F EPS is now pegged to 6.5x, slightly above its -1SD level of 5x given we expect its earnings growth to remain above 2008 levels. Consequently, we cut our call from Buy to NEUTRAL, despite Kossan's more balanced product mix than peers, and highest exposure to Western countries amongst peers, which we forecast will see moderating growth rates in demand over the next few years.

**Fig. 76: KRI: P/E bands**



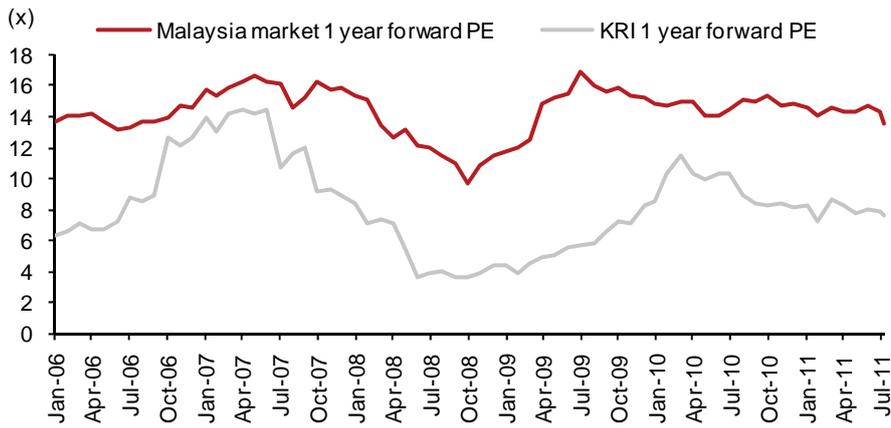
Source: Bloomberg, Nomura Research

**Fig. 77: KRI: Forward P/E**



Source: Bloomberg, Nomura Research

**Fig. 78: KRI: Historical discount to market**



Source: Bloomberg, Nomura Research

**Fig. 79: Changes in assumptions**

	New assumptions		Old assumptions	
	FY11F	FY12F	FY11F	FY12F
Latex price (MYR/kg)	9.5	8.5	8.8	8.0
MYR/USD	2.9	2.77	3.0	3.0
Revenue growth (%)	24.0	13.9	15.1	5.2
Earnings growth (%)	(1.8)	10.2	150.4	6.5
EBITDA margin (%)	14.5	14.7	34.9	35.1
Net margin (%)	8.6	8.4	24.9	25.2

Source: Nomura estimates

## Valuation methodology

We peg Kossan's target price to a 6.5x FY12F P/E multiple (from 10x FY11F previously). Applied to our FY11F EPS of MYR0.39, we arrive at our target price of MYR2.51.

## Risks

Potential downside to our view includes delays / hiccups to the new product launch, which could affect Kossan's strategy to gain market share from other nitrile players and the higher-end segment. Upside risks include sharp easing of latex prices and appreciable demand rebound from FY12F.

## Deep value for nitrile exposure Familiar industry risks well baked into valuations

September 27, 2011

<b>Rating</b> Remains	<b>Buy</b>
<b>Target price</b> Reduced from 7.00	MYR 2.88
<b>Closing price</b> September 23, 2011	MYR 2.37
<b>Potential upside</b>	+21.5%

### Action: Value, given lower earnings contractions, better product mix

We see deep value in Supermax's current share price; it has seen lower y-y earnings contractions than peers owing to a higher (ie, 34%) nitrile product mix (vs. c.13% for TOPG and 50% for KRI), while its own-brand distribution arm provides an alternative earnings source. We forecast that earnings will be down 36% for FY11F versus Top Glove's 53%. On a y-y basis, 1H11 output is c. 4% higher, again in a comparatively better position than peers who have reported y-y lower output.

### Catalysts: Yield support on increased dividend policy; easing costs

Management has announced an increase in its payout ratio to 30% from FY12F (from 20%), bringing FY12F yield to 5.6%. Given the c. 4% earnings sensitivity to every 1% change in rubber prices, we expect the 36% earnings growth in FY12F to be driven primarily by the 10% easing in rubber prices so far. Demand visibility is marginally better than peers given its 34% exposure to nitrile (3 months ahead, vs. peers' 1.5 months); however, most glovemakers are focusing on switching capacity to nitrile gloves now – our FY12F revenue growth assumptions remain below average levels of 5% to reflect lower industry demand visibility.

### Valuation: At 5.4x FY12F PE, trading at APLI write-off levels

We have adjusted our TP to incorporate macro conditions and a muted short-term outlook for the industry – our target multiple is now 6.5x from 11.5x (implying a wider discount to market of 52% from 26%). Post-APLI, PE valuations have ranged from 6x to 16x. During the '08 downturn, valuations bottomed at 2-3x; however, we believe those bear-case valuations do not reflect the better operations post-APLI.

### Anchor themes

Easing costs are likely to remove earnings pressure on glovemakers, however near-term demand visibility remains limited on continued capacity expansions. However, opportunities for new markets in the long term exist, eg, in China.

### Nomura vs consensus

We are broadly in line with consensus on earnings; however, we differ in that we have stronger in-house RM appreciation forecasts.

### Research analysts

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31 Dec	FY10	FY11F		FY12F		FY13F	
Currency (MYR)	Actual	Old	New	Old	New	Old	New
<b>Revenue (mn)</b>	977	1,172	1,133	1,373	1,190		1,304
<b>Reported net profit (mn)</b>	169	204	108	215	149		170
<b>Normalised net profit (mn)</b>	169	204	108	215	149		170
<b>Normalised EPS</b>	50.39c	60.83c	32.18c	64.27c	44.44c		50.80c
<b>Norm. EPS growth (%)</b>	36.4	20.7	-36.1	5.6	38.1		14.3
<b>Norm. P/E (x)</b>	4.7	N/A	7.4	N/A	5.3	N/A	4.7
<b>EV/EBITDA (x)</b>	4.3	3.0	5.1	2.6	3.6		3.0
<b>Price/book (x)</b>	1.1	N/A	1.0	N/A	0.9	N/A	0.8
<b>Dividend yield (%)</b>	4.0	N/A	2.7	N/A	5.6	N/A	6.4
<b>ROE (%)</b>	27.0	25.8	14.8	22.4	17.8		17.7
<b>Net debt/equity (%)</b>	28.7	8.1	16.7	0.6	5.5		net cash

Source: Nomura estimates

**Key company data:** See page 2 for company data and detailed price/index chart.

**Rating:** See report end for details of Nomura's rating system.

See Appendix A-1 for analyst certification and important disclosures. Analysts employed by non US affiliates are not registered or qualified as research analysts with FINRA in the US.

# Key data on Supermax Corp Bhd

## Income statement (MYRmn)

Year-end 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
<b>Revenue</b>	<b>804</b>	<b>977</b>	<b>1,133</b>	<b>1,190</b>	<b>1,304</b>
Cost of goods sold	-579	-685	-899	-907	-999
<b>Gross profit</b>	<b>224</b>	<b>292</b>	<b>234</b>	<b>283</b>	<b>304</b>
SG&A	-103	-126	-129	-133	-133
Employee share expense	0	0	0	0	0
<b>Operating profit</b>	<b>121</b>	<b>166</b>	<b>105</b>	<b>150</b>	<b>171</b>
<b>EBITDA</b>	<b>152</b>	<b>192</b>	<b>141</b>	<b>188</b>	<b>211</b>
Depreciation	-31	-26	-37	-38	-40
Amortisation	0	0	0	0	0
EBIT	121	166	105	150	171
Net interest expense	-17	-14	-19	-20	-21
Associates & JCEs	42	42	42	47	51
Other income	0	0	0	0	0
<b>Earnings before tax</b>	<b>146</b>	<b>194</b>	<b>128</b>	<b>176</b>	<b>201</b>
Income tax	-22	-25	-20	-27	-31
<b>Net profit after tax</b>	<b>124</b>	<b>169</b>	<b>108</b>	<b>149</b>	<b>170</b>
Minority interests	0	0	0	0	0
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
<b>Normalised NPAT</b>	<b>124</b>	<b>169</b>	<b>108</b>	<b>149</b>	<b>170</b>
Extraordinary items	-5	0	0	0	0
<b>Reported NPAT</b>	<b>119</b>	<b>169</b>	<b>108</b>	<b>149</b>	<b>170</b>
Dividends	-24	-32	-22	-45	-51
<b>Transfer to reserves</b>	<b>95</b>	<b>137</b>	<b>86</b>	<b>104</b>	<b>119</b>

## Valuation and ratio analysis

FD normalised P/E (x)	6.4	4.7	7.4	5.3	4.7
FD normalised P/E at price target (x)	7.8	5.7	8.9	6.5	5.7
Reported P/E (x)	6.7	4.7	7.4	5.3	4.7
Dividend yield (%)	3.0	4.0	2.7	5.6	6.4
Price/cashflow (x)	3.4	12.9	5.5	5.3	4.9
Price/book (x)	1.4	1.1	1.0	0.9	0.8
EV/EBITDA (x)	5.1	4.3	5.1	3.6	3.0
EV/EBIT (x)	6.0	4.8	6.4	4.4	3.5
Gross margin (%)	27.9	29.9	20.6	23.8	23.3
EBITDA margin (%)	19.0	19.6	12.5	15.8	16.2
EBIT margin (%)	15.1	17.0	9.2	12.6	13.1
Net margin (%)	14.8	17.3	9.5	12.5	13.1
Effective tax rate (%)	15.3	12.8	15.4	15.4	15.4
Dividend payout (%)	20.0	18.8	20.0	30.0	30.0
Capex to sales (%)	2.8	4.8	5.1	2.5	2.3
Capex to depreciation (x)	0.7	1.8	1.6	0.8	0.7
ROE (%)	24.2	27.0	14.8	17.8	17.7
ROA (pretax %)	18.8	23.3	14.1	17.3	18.6

## Growth (%)

Revenue	-1.0	21.6	15.9	5.1	9.6
EBITDA	19.4	25.8	-26.4	33.2	12.3
EBIT	22.6	36.8	-37.0	43.3	14.3
Normalised EPS	34.0	36.4	-36.1	38.1	14.3
Normalised FDEPS	34.0	36.4	-36.1	38.1	14.3

## Per share

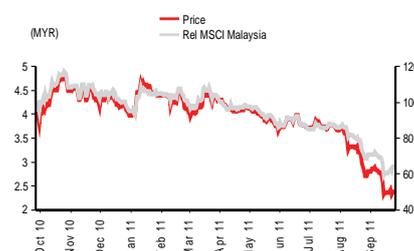
Reported EPS (MYR)	35.36c	50.39c	32.18c	44.44c	50.80c
Norm EPS (MYR)	36.96c	50.39c	32.18c	44.44c	50.80c
Fully diluted norm EPS (MYR)	36.96c	50.39c	32.18c	44.44c	50.80c
Book value per share (MYR)	1.66	2.06	2.30	2.68	3.06
DPS (MYR)	0.07	0.09	0.06	0.13	0.15

Source: Nomura estimates

## Notes

2012 earnings rebound solely on current decrease in natural latex prices by 10%, still conservative on 2012 revenue growth, in our view

## Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (MYR)	-20.2	-37.5	-41.2
Absolute (USD)	-26.1	-40.6	-43.1
Relative to index	-11.3	-23.5	-34.1
Market cap (USDmn)	251.7		
Estimated free float (%)	58.0		
52-week range (MYR)	4.86/2.26		
3-mth avg daily turnover (USDmn)	0.84		
Major shareholders (%)			
Dato Seri Stanley Thai	20.7		
Datin Seri Cheryl Tan	15.3		

**Cashflow (MYRmn)**

Year-end 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
EBITDA	152	192	141	188	211
Change in working capital	91	-110	49	-9	-13
Other operating cashflow	-8	-20	-46	-29	-35
<b>Cashflow from operations</b>	<b>236</b>	<b>61</b>	<b>144</b>	<b>150</b>	<b>163</b>
Capital expenditure	-23	-47	-58	-30	-30
<b>Free cashflow</b>	<b>213</b>	<b>15</b>	<b>87</b>	<b>120</b>	<b>133</b>
Reduction in investments	-39	-42	-42	-47	-51
Net acquisitions	0	0	0	0	0
Reduction in other LT assets	0	6	-1	-1	-1
Addition in other LT liabilities	1	5	0	0	0
Adjustments	29	32	44	49	54
<b>Cashflow after investing acts</b>	<b>203</b>	<b>15</b>	<b>88</b>	<b>121</b>	<b>135</b>
Cash dividends	-19	-32	-32	-22	-45
Equity issue	4	6	0	0	0
Debt issue	0	6	0	0	0
Convertible debt issue	0	0	0	0	0
Others	-100	-17	38	-5	-5
<b>Cashflow from financial acts</b>	<b>-115</b>	<b>-37</b>	<b>6</b>	<b>-27</b>	<b>-50</b>
<b>Net cashflow</b>	<b>88</b>	<b>-22</b>	<b>94</b>	<b>95</b>	<b>85</b>
Beginning cash	31	119	97	192	286
Ending cash	119	97	192	286	371
Ending net debt	176	198	129	49	-20

Source: Nomura estimates

**Notes**

Still positive operating cashflow despite earnings contractions

**Balance sheet (MYRmn)**

As at 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
Cash & equivalents	119	97	192	286	371
Marketable securities	0	0	0	0	0
Accounts receivable	140	215	233	244	268
Inventories	106	133	197	190	206
Other current assets	0	0	0	0	0
<b>Total current assets</b>	<b>365</b>	<b>445</b>	<b>621</b>	<b>721</b>	<b>845</b>
LT investments	155	198	240	286	337
Fixed assets	374	388	405	396	386
Goodwill	29	29	29	29	29
Other intangible assets	0	0	0	0	0
Other LT assets	11	6	7	8	9
<b>Total assets</b>	<b>934</b>	<b>1,065</b>	<b>1,301</b>	<b>1,440</b>	<b>1,606</b>
Short-term debt	129	155	129	129	129
Accounts payable	61	60	192	188	214
Other current liabilities	12	4	4	4	4
<b>Total current liabilities</b>	<b>202</b>	<b>220</b>	<b>324</b>	<b>320</b>	<b>346</b>
Long-term debt	165	141	192	207	222
Convertible debt	0	0	0	0	0
Other LT liabilities	9	14	14	14	14
<b>Total liabilities</b>	<b>376</b>	<b>374</b>	<b>529</b>	<b>541</b>	<b>581</b>
Minority interest	0	0	0	0	0
Preferred stock	0	0	0	0	0
Common stock	134	170	170	170	170
Retained earnings	317	446	522	649	775
Proposed dividends	0	0	4	4	4
Other equity and reserves	107	76	76	76	76
<b>Total shareholders' equity</b>	<b>558</b>	<b>691</b>	<b>772</b>	<b>899</b>	<b>1,025</b>
<b>Total equity &amp; liabilities</b>	<b>934</b>	<b>1,065</b>	<b>1,301</b>	<b>1,440</b>	<b>1,606</b>

**Notes**

Gearing still below its max levels of 0.5 to 0.7x (net)

**Liquidity (x)**

Current ratio	1.80	2.03	1.92	2.25	2.44
Interest cover	7.2	11.6	5.4	7.4	8.1

**Leverage**

Net debt/EBITDA (x)	1.15	1.03	0.91	0.26	net cash
Net debt/equity (%)	31.5	28.7	16.7	5.5	net cash

**Activity (days)**

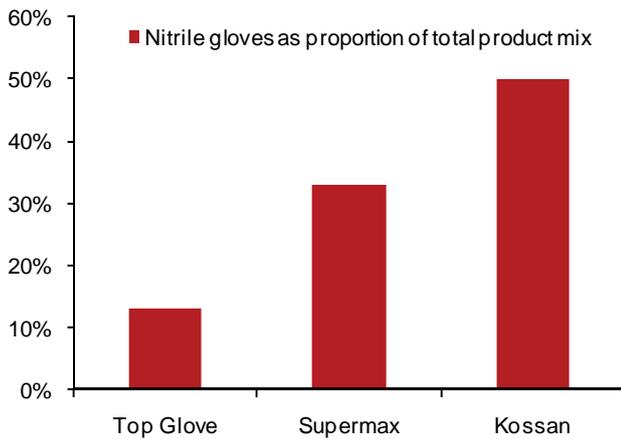
Days receivable	86.4	66.2	72.1	73.4	71.7
Days inventory	76.0	63.6	67.0	78.1	72.3
Days payable	53.6	32.3	51.1	76.6	73.4
Cash cycle	108.9	97.5	88.0	74.9	70.7

Source: Nomura estimates

# Deep value; operations continue to improve post-APLI write-off

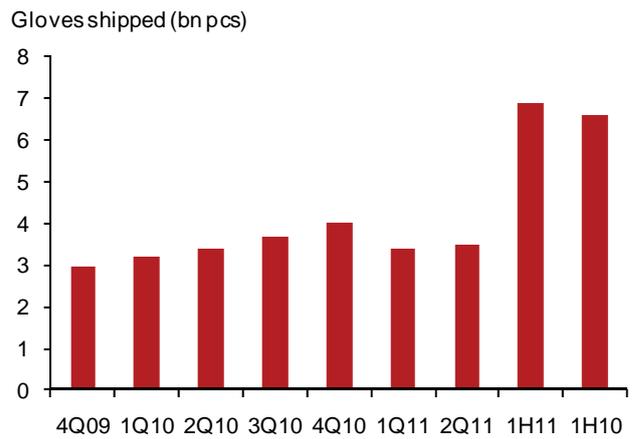
Unlike peers that have reported y-y volume declines off 2010 highs, Supermax shipped 4% more gloves in 1H11 than in 1H10. Post its write-off of an unprofitable investment in APLI (a glovemaker) in 2009, its focus has continued to be on growing the Supermax's own-brand manufacturing and distribution as an alternative revenue source to contract manufacturing (its own-brand arm now comprises 68% of the sales mix vs. 64% last year). Its own distribution centres are located in countries where it sees opportunities to increase its export share (see figure titled "Has a direct presence in countries where it sees opportunities to increase market share" below) of gloves, allowing it to maintain on-the-ground ties with customers and capitalize on any opportunities quickly.

**Fig. 80: Malaysian glovemakers' nitrile gloves exposure**



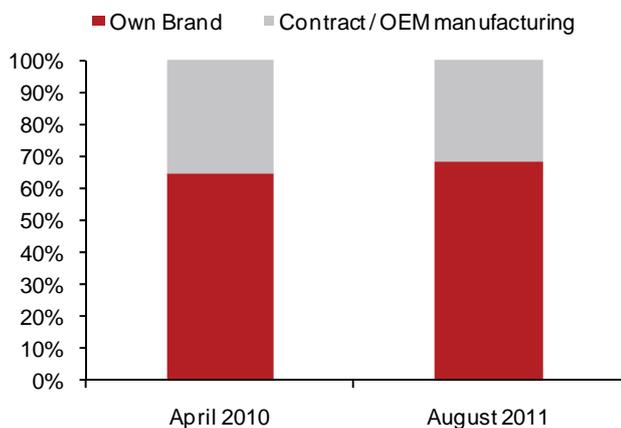
Source: Respective company data

**Fig. 81: Unlike Top Glove, Supermax output is showing 4% growth y-y**



Source: Company data

**Fig. 82: Own-brand manufacturing continues to be focus – now 68% of sales mix versus 64% last year**



Source: Company data

**Fig. 83: Has a direct presence in countries where it sees opportunities to increase market share**



Note: Market share represents total imports of each respective country from Malaysia  
Source: Espicom

Owing to the demand switch from natural latex to nitrile gloves last year on the back of extreme increases in the cost of natural latex, Supermax responded by shifting its production mix towards nitrile gloves beginning 2H10. As such, volumes shipped y-y are still showing 4% growth versus the peers, such as Top Glove, that have a higher natural latex product mix and that are seeing y-y declines in output.

**Fig. 84: Shift to nitrile started in 2H10**

As a % of total	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11
Surgical	3	3	3	3	3	3
Nitrile gloves (powdered and powder free)	20	20	25	31	34	34
Natural latex (powdered and powder free)	77	77	72	66	63	63

Source: Company data

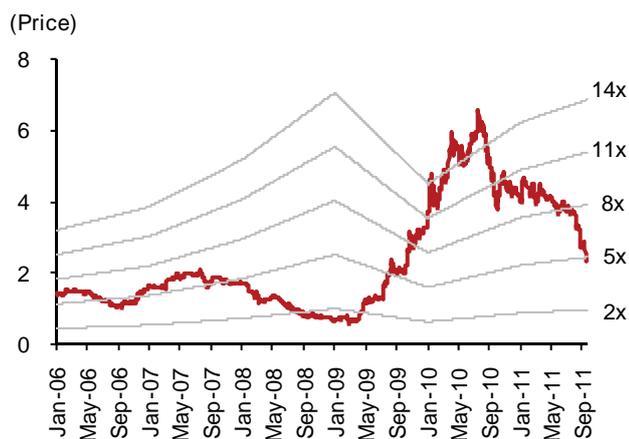
We adjusted our assumptions to impute the high ytd latex price, our revised in-house foreign-exchange forecasts as well as the revised in-house assumptions of RM8.50/kg (for rationale, please see our sector report above) for 2012.

Given that Supermax’s operational and managerial resources were heavily involved in dealing with its APLI acquisition prior to end-09, we think a more relevant valuation benchmark would be the post-2009 period – average PE was 10x, -1SD level was 7x from 4Q09 to present. We note, however, that during the ’08 recession, PE valuations bottomed at 2-3x (-1SD was 3x). Given much better operations currently, and after accounting for the current macro and industry conditions, we think a fair and reasonable target PE multiple would be 6.5x.

Post its 2Q11 results briefing, Supermax also announced an increase in dividend policy from 20% to 30% next year – based on current share-price levels, this boosts dividend yields to 5.6%, which provides additional support to the share price.

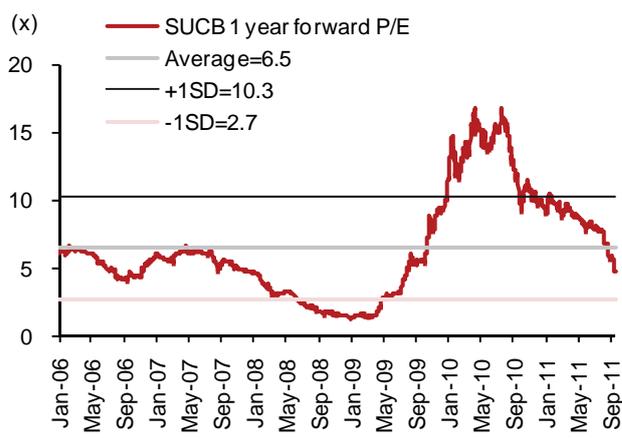
On pegging our revised FY12F EPS to a target multiple of 6.5x we derive a TP of RM2.88, and maintain our BUY rating; we continue to see value in Supermax post-APLI, on its ability to maintain growth in output (albeit minor) beyond 2010, and an alternative earnings source via selling its own-brand gloves.

**Fig. 85: SUCB: PE bands**



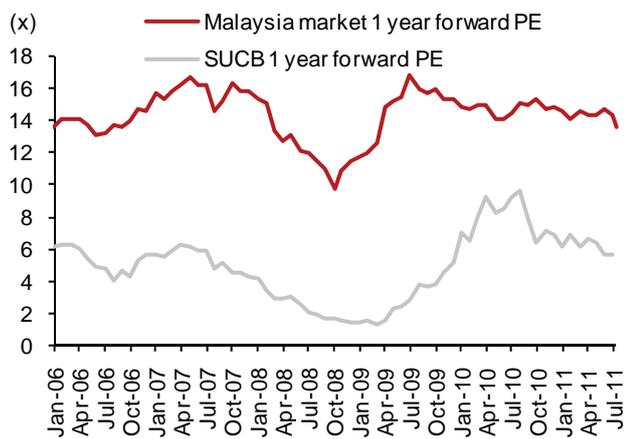
Source: Bloomberg, Nomura Research

**Fig. 86: SUCB: Forward PE**



Source: Bloomberg, Nomura Research

**Fig. 87: Historical discount to market**



Source: Bloomberg, Nomura

**Fig. 88: Assumptions**

	New assumptions		Old assumptions	
	FY11F	FY12F	FY11F	FY12F
Latex price (MYR/kg)	9.5	8.5	8.5	8
MYR/ USD	2.9	2.77	3.0	3.0
Revenue growth (%)	15.9	5.1	10.5	17.1
Earnings growth (%)	(36.1)	38.1	20.7	5.6
EBITDA margin (%)	12.5	15.8	20.0	17.2
Net margin (%)	9.5	12.5	17.4	15.7

Source: Nomura research

**Valuation Methodology**

We peg Supermax’s target P/E at 6.5x, from 11.5x previously, following market-multiple compressions. Applying this to FY12F EPS of RM0.44, we derive our target price of RM2.88.

**Risks**

Downside risks to our target price include industry-related factors similar to those facing Top Glove, as well as adverse and rapid currency movements that could affect income from the company’s overseas distribution arms.

## Still low visibility, valuation compression Market may punish demand uncertainty

September 27, 2011

<b>Rating</b> Down from Neutral	<b>Reduce</b>
<b>Target price</b> Reduced from 5.00	MYR 3.42
<b>Closing price</b> September 23, 2011	MYR 4.00
<b>Potential downside</b>	-14.5%

### Action: Unchanged low visibility could be disappointment in these markets

Our company visit this month revealed 1) a slower rebound in output (only 2-3% above normal 2009 levels) and 2) continued delays in factory expansions (for the third time now). The relatively unchanged operations sequentially lead us to believe that 4Q11 (results out October 11) could be a flat quarter at best. Earnings have bottomed, in our view, but visibility remains poor, and macro and demand-side risks could impede the extent of any rebound in 2012.

### Catalysts: 2012 to improve from easing costs, but demand visibility uncertain

We see the easing and stabilization of latex prices improving the bottom line in FY12F from FY11F (Nomura assumption: RM8.50/kg for 2012). While most players have delayed (but not cancelled) expansion plans, the resulting capacity increase in FY12F may lead to continued lower sales volume visibility in 2012. To incrementally boost output, Top Glove is planning to cultivate more orders from MNCs, which previously had not been given much focus before.

### Valuation: Macro conditions / market multiple compression necessitate lowering of target multiple to 12x

Uncertain macro conditions and low visibility lead us to apply FY12F EPS to a base-case target multiple of 12x, midway between its mean and +1SD level. An extreme bear case scenario (similar to 2008) could see valuations compress further, e.g., down to 9x. Despite expecting a 50%-plus earnings rebound in FY12F on lower costs, valuations are c. on par with the market at 14x vs the historical market discount of 38% (Aug '07-Aug '09).

### Anchor themes

Easing costs are likely to remove earnings pressure on glovemakers, however near-term demand visibility remains limited on continued capacity expansions. However, opportunities for new markets in the long term exist, e.g., China.

### Nomura vs consensus

We are broadly in line with consensus.

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31 Aug	FY10	FY11F		FY12F		FY13F	
Currency (MYR)	Actual	Old	New	Old	New	Old	New
<b>Revenue (mn)</b>	2,079	2,292	2,263	2,500	2,475	2,590	2,518
<b>Reported net profit (mn)</b>	245	202	115	224	180	237	199
<b>Normalised net profit (mn)</b>	245	202	115	224	180	237	199
<b>Normalised EPS</b>	39.65c	32.64c	18.60c	36.25c	29.06c	38.28c	32.23c
<b>Norm. EPS growth (%)</b>	38.7	-17.7	-53.1	11.1	56.3	5.6	10.9
<b>Norm. P/E (x)</b>	10.3	N/A	22.0	N/A	14.1	N/A	12.7
<b>EV/EBITDA (x)</b>	6.0	6.7	10.7	5.7	7.1	4.9	5.9
<b>Price/book (x)</b>	2.4	N/A	2.3	N/A	2.0	N/A	1.9
<b>Dividend yield (%)</b>	4.0	N/A	1.8	N/A	2.9	N/A	3.2
<b>ROE (%)</b>	26.5	18.6	10.9	18.4	15.6	17.3	15.7
<b>Net debt/equity (%)</b>	net cash						

Source: Nomura estimates

**Key company data:** See page 2 for company data and detailed price/index chart.

**Rating:** See report end for details of Nomura's rating system.

See Appendix A-1 for analyst certification and important disclosures. Analysts employed by non US affiliates are not registered or qualified as research analysts with FINRA in the US.

# Key data on Top Glove Corp

## Income statement (MYRmn)

Year-end 31 Aug	FY09	FY10	FY11F	FY12F	FY13F
<b>Revenue</b>	<b>1,529</b>	<b>2,079</b>	<b>2,263</b>	<b>2,475</b>	<b>2,518</b>
Cost of goods sold	-1,156	-1,630	-1,972	-2,093	-2,104
<b>Gross profit</b>	<b>373</b>	<b>449</b>	<b>291</b>	<b>382</b>	<b>414</b>
SG&A	-142	-142	-157	-161	-166
Employee share expense	0	0	0	0	0
<b>Operating profit</b>	<b>231</b>	<b>307</b>	<b>135</b>	<b>220</b>	<b>248</b>
<b>EBITDA</b>	<b>288</b>	<b>366</b>	<b>201</b>	<b>292</b>	<b>324</b>
Depreciation	-57	-59	-66	-72	-77
Amortisation	0	0	0	0	0
EBIT	231	307	135	220	248
Net interest expense	-9	-1	-1	-1	-1
Associates & JCEs	-1	-1	-1	-1	-1
Other income	0	0	16	18	18
<b>Earnings before tax</b>	<b>222</b>	<b>306</b>	<b>149</b>	<b>236</b>	<b>264</b>
Income tax	-54	-56	-33	-55	-61
<b>Net profit after tax</b>	<b>168</b>	<b>250</b>	<b>116</b>	<b>182</b>	<b>203</b>
Minority interests	1	-5	-2	-4	-4
Other items	0	0	1	2	0
Preferred dividends	0	0	0	0	0
<b>Normalised NPAT</b>	<b>169</b>	<b>245</b>	<b>115</b>	<b>180</b>	<b>199</b>
Extraordinary items	0	0	0	0	0
<b>Reported NPAT</b>	<b>169</b>	<b>245</b>	<b>115</b>	<b>180</b>	<b>199</b>
Dividends	-76	-99	-46	-71	-80
<b>Transfer to reserves</b>	<b>92</b>	<b>146</b>	<b>69</b>	<b>108</b>	<b>119</b>

## Valuation and ratio analysis

FD normalised P/E (x)	14.0	10.3	22.0	14.1	12.7
FD normalised P/E at price target (x)	11.8	8.7	18.4	11.8	10.6
Reported P/E (x)	14.0	10.1	21.5	13.8	12.4
Dividend yield (%)	3.2	4.0	1.8	2.9	3.2
Price/cashflow (x)	7.1	9.4	38.0	16.4	10.0
Price/book (x)	2.9	2.4	2.3	2.0	1.9
EV/EBITDA (x)	8.0	6.0	10.7	7.1	5.9
EV/EBIT (x)	10.0	7.1	16.0	9.4	7.8
Gross margin (%)	24.4	21.6	12.9	15.4	16.4
EBITDA margin (%)	18.8	17.6	8.9	11.8	12.9
EBIT margin (%)	15.1	14.8	6.0	8.9	9.8
Net margin (%)	11.0	11.8	5.1	7.3	7.9
Effective tax rate (%)	24.3	18.2	22.4	23.2	23.0
Dividend payout (%)	45.3	40.3	39.6	39.6	40.2
Capex to sales (%)	4.4	3.4	3.1	2.9	2.9
Capex to depreciation (x)	1.2	1.2	1.1	1.0	0.9
ROE (%)	22.6	26.5	10.9	15.6	15.7
ROA (pretax %)	23.8	29.1	11.2	17.5	19.4

## Growth (%)

Revenue	11.0	36.0	8.8	9.3	1.8
EBITDA	46.3	27.2	-45.1	45.1	11.0
EBIT	60.6	33.0	-56.2	63.6	12.3
Normalised EPS	59.5	38.7	-53.1	56.3	10.9
Normalised FDEPS	59.5	35.8	-53.1	56.3	10.9

## Per share

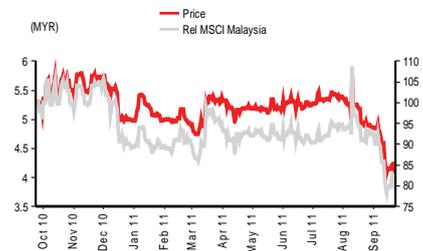
Reported EPS (MYR)	28.59c	39.65c	18.60c	29.06c	32.23c
Norm EPS (MYR)	28.59c	39.65c	18.60c	29.06c	32.23c
Fully diluted norm EPS (MYR)	28.59c	38.82c	18.21c	28.46c	31.56c
Book value per share (MYR)	1.40	1.65	1.77	1.96	2.16
DPS (MYR)	0.13	0.16	0.07	0.12	0.13

Source: Nomura estimates

## Notes

FY12F earnings rebound expected on mostly lower costs (assumptions are that current latex prices of RM8.50/kg or so stabilize and hold)

## Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (MYR)	-18.7	-23.4	-21.6
Absolute (USD)	-24.0	-26.5	-23.4
Relative to index	-11.3	-10.8	-16.0
Market cap (USDmn)	779.4		
Estimated free float (%)	55.0		
52-week range (MYR)	5.88/3.85		
3-mth avg daily turnover (USDmn)	1.27		
Major shareholders (%)			
Tan Sri Dato Seri Lim Wee Chai	39.5		

**Cashflow (MYRmn)**

Year-end 31 Aug	FY09	FY10	FY11F	FY12F	FY13F
EBITDA	288	366	201	292	324
Change in working capital	87	-63	-38	-31	16
Other operating cashflow	-44	-35	-97	-108	-87
<b>Cashflow from operations</b>	<b>331</b>	<b>268</b>	<b>66</b>	<b>154</b>	<b>253</b>
Capital expenditure	-67	-70	-70	-72	-72
<b>Free cashflow</b>	<b>264</b>	<b>198</b>	<b>-4</b>	<b>82</b>	<b>181</b>
Reduction in investments	1	1	1	1	1
Net acquisitions					
Reduction in other LT assets	-15	-3	-3	-4	-5
Addition in other LT liabilities	3	0	0	0	0
Adjustments	1	-3	42	73	38
<b>Cashflow after investing acts</b>	<b>254</b>	<b>194</b>	<b>36</b>	<b>151</b>	<b>216</b>
Cash dividends	-32	-98	-46	-71	-80
Equity issue	11	0	0	0	0
Debt issue	-165	-12	-6	0	-3
Convertible debt issue	0	0	0	0	0
Others	-4	34	42	3	10
<b>Cashflow from financial acts</b>	<b>-190</b>	<b>-75</b>	<b>-9</b>	<b>-69</b>	<b>-73</b>
<b>Net cashflow</b>	<b>64</b>	<b>118</b>	<b>27</b>	<b>83</b>	<b>142</b>
Beginning cash	122	186	304	330	413
Ending cash	185	304	331	413	556
Ending net debt	-165	-295	-327	-410	-556

Source: Nomura estimates

**Notes**

Operating cashflows to improve into FY12F on the back of an earnings improvement and steadier costs

**Balance sheet (MYRmn)**

As at 31 Aug	FY09	FY10	FY11F	FY12F	FY13F
Cash & equivalents	186	304	330	413	556
Marketable securities	0	0	0	0	0
Accounts receivable	207	301	339	373	370
Inventories	119	226	248	264	256
Other current assets	0	0	0	0	1
<b>Total current assets</b>	<b>511</b>	<b>831</b>	<b>917</b>	<b>1,050</b>	<b>1,182</b>
LT investments	9	8	7	7	6
Fixed assets	564	573	576	577	572
Goodwill	20	20	20	20	20
Other intangible assets	0	0	0	0	0
Other LT assets	27	30	33	37	42
<b>Total assets</b>	<b>1,132</b>	<b>1,462</b>	<b>1,554</b>	<b>1,691</b>	<b>1,823</b>
Short-term debt	12	6	0	0	0
Accounts payable	197	335	357	376	383
Other current liabilities	36	36	36	36	36
<b>Total current liabilities</b>	<b>244</b>	<b>376</b>	<b>393</b>	<b>412</b>	<b>418</b>
Long-term debt	9	3	3	3	0
Convertible debt	0	0	0	0	0
Other LT liabilities	33	33	33	33	33
<b>Total liabilities</b>	<b>286</b>	<b>413</b>	<b>429</b>	<b>448</b>	<b>452</b>
Minority interest	21	27	29	33	37
Preferred stock	0	0	0	0	0
Common stock	152	162	165	168	168
Retained earnings	445	597	668	778	902
Proposed dividends	0	0	0	0	0
Other equity and reserves	227	264	264	264	264
<b>Total shareholders' equity</b>	<b>825</b>	<b>1,023</b>	<b>1,096</b>	<b>1,210</b>	<b>1,334</b>
<b>Total equity &amp; liabilities</b>	<b>1,132</b>	<b>1,462</b>	<b>1,554</b>	<b>1,691</b>	<b>1,823</b>

**Notes**

Balance sheet fairly well positioned to ride any downturn

**Liquidity (x)**

Current ratio	2.10	2.21	2.33	2.55	2.83
Interest cover	27.1	481.9	211.1	345.4	388.0

**Leverage**

Net debt/EBITDA (x)	net cash				
Net debt/equity (%)	net cash				

**Activity (days)**

Days receivable	51.9	44.5	51.6	52.6	53.8
Days inventory	43.7	38.6	43.9	44.8	45.1
Days payable	60.8	59.5	64.0	64.1	65.8
Cash cycle	34.9	23.6	31.4	33.3	33.1

Source: Nomura estimates

# Demand visibility still low, valuations unjustified

Despite the easing in latex prices year to date, we believe Top Glove will likely continue to underperform into 2012, owing to the following:

- Delays in expansions evidencing weak demand visibility
- Unjustified valuations despite an anticipated earnings rebound from current cost easing ytd

**Fig. 89: Expansions have been delayed 3 times**

Factory	Location	No. of additional lines	Capacity p.a	Target completion (announced in 1Q11)	Target completion (announced in 2Q11)	Target completion (announced in 3Q11)	Target completion (per Sept 13 management visit)
Factory 21	Klang, Malaysia	16	1.5 billion pcs	Mar-11	Apr-11	Operational in May 2011	Operational in May 2011
Factory 7	Sadao, Thailand	16	1.5 billion pcs	Apr-11	Aug-11	Aug-11	Nov-11
Factory 22	Klang, Malaysia	16	1.5 billion pcs	Jun-11	Aug-11	Oct-11	Dec-11
Factory 23	Ipoh, Malaysia	32	3.3 billion pcs	Aug-11	Aug-11	Phase 1 in Aug 2011, Phase 2 in March 2011	Phase 1 in Nov 2011, Phase 2 in May 2012
<b>Total</b>		<b>80</b>	<b>7.7 billion pcs</b>				

Source: Company data

While we believe the worst of the cost headwinds are likely over given the recent correction of rubber prices on the back of easing tight supply, (and we do expect Top Glove to recover the earnings contractions experienced by FY12F on easing costs), demand visibility for its main product line – natural latex gloves – remains weak, with output still down y-y and only marginally (2-3%) above 2009 levels. This implies output growth below market of high single digits on average.

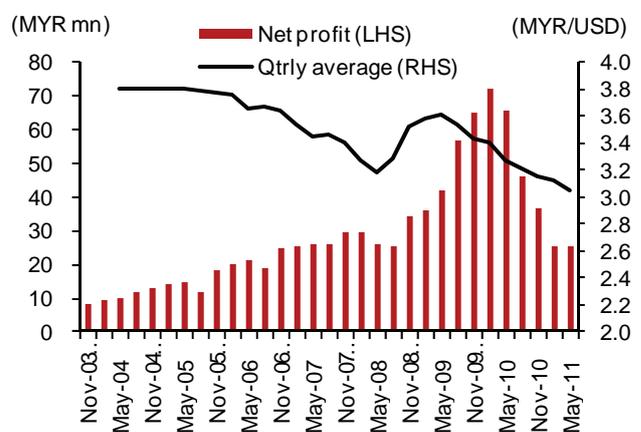
Evidencing this still uninspiring outlook is the delay in the company's expansion plans for the third time this financial year by another two months, on average, while no new expansions are planned beyond Factory 23. While management highlights that these new expansions are mostly for nitrile gloves (in which it is trying to expand and gain share), this nevertheless implies capacity expansion growth in 2012 of 18%, its highest expansion since 2007.

**Fig. 90: 9M11 vs 9M10**

	9M11	9M10	% chg y-y
Revenue	1511.9	1538.1	(1.7)
Operating Expenses	(1413.2)	(1280.6)	10.4
Operating profit	109.7	265.4	(58.7)
Operating Margin	7.3	17.3	(10.0)
Interest Expense	(0.2)	(0.6)	(72.5)
Tax	(22.5)	(59.7)	(62.2)
PAT	87.0	200.2	(56.5)
Net Profit Margin	5.8	13.0	(7.3)

Source: Company data

**Fig. 91: Given earnings are now back to old historical levels**

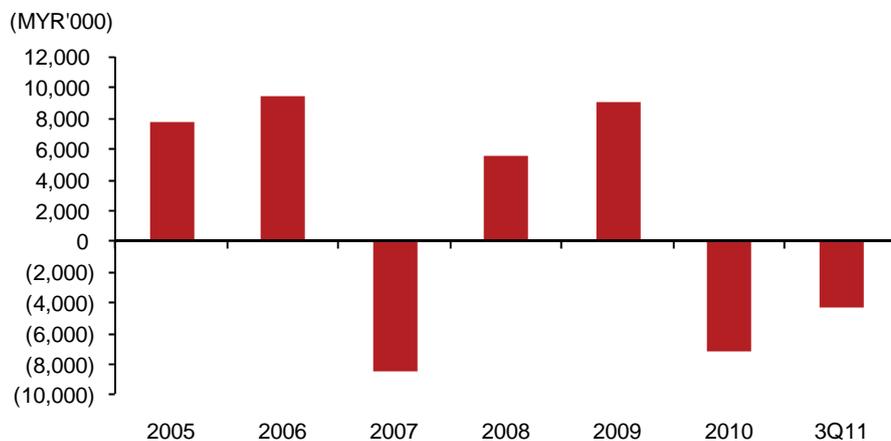


Source: Nomura, company data

The company is moving to cultivate more business relationships and expanding its clientele base with international majors like Kimberly Clark, which previously had not been given focus before due to an inclination to avoid having too large exposure to a single customer during previous years when Top Glove was a much smaller size. Any upside to output could provide some upside support to the share price, but until that happens, we think in light of current macro conditions as well as the recent market contraction, we do not think valuations should continue to trade at a premium to the market.

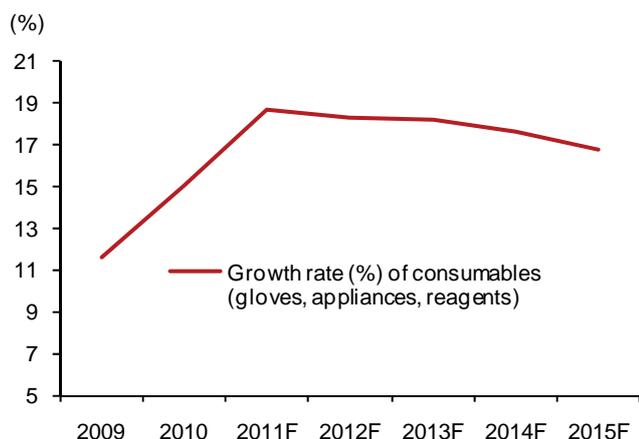
China continues to remain on the radar of most glovemakers, given growth rates in the minor consumables market of c. 17-18% for the next five years is forecasted to exceed overall market growth. Top Glove is the first Malaysian glovemaking under our coverage to venture into China, and has two factories there manufacturing mostly vinyl gloves. Profitability continues to fluctuate given most Chinese manufacturers are in vinyl gloves (high competition), however we think the years of experience in China accords it some degree of familiarity in the market and positions it to benefit should a shift in demand to natural rubber gloves occur (where Chinese manufacturers do not have the advantage).

**Fig. 92: China : Operating profit trend**



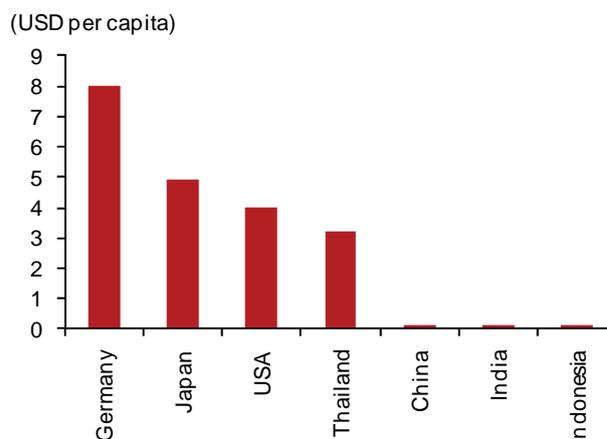
Source: Company data

**Fig. 93: China : Growth rate of minor consumables like gloves are expected to grow above other markets**



Source: Espicom

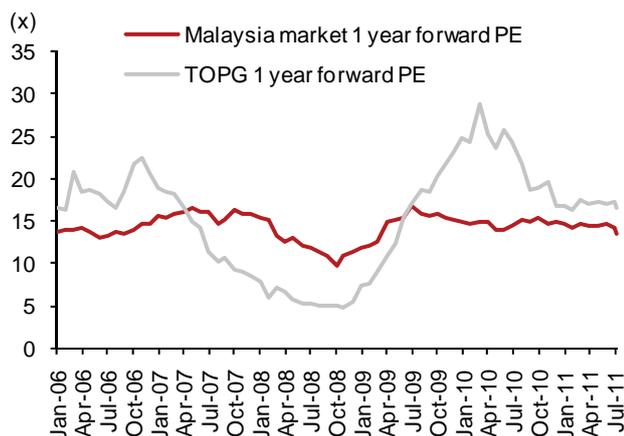
**Fig. 94: China : Minor consumables expenditure per capita**



Source: Espicom

Despite the long-term demand from China angle, we move our call from Neutral to REDUCE in the near term on the back of continued weak visibility despite some relief in cost pressures contributing to a rebound in earnings in 2012F, also as fundamentals do not justify the valuations currently, in our view, with Top Glove trading at a premium to the Malaysian market on the back of a recent decline in the market multiple. We have reduced our FY12F earnings-based target price to RM3.42 from RM5.00 on the back a cut in earnings arising from the delayed expansions at a utilization rate of 65% (below the company's current 70%) and pegging our revised FY12F EPS to a new target multiple of 12x versus the previous assumption of 15.4x, its average historical P/E multiple.

**Fig. 95: We do not think trading at a premium to the market is justified**



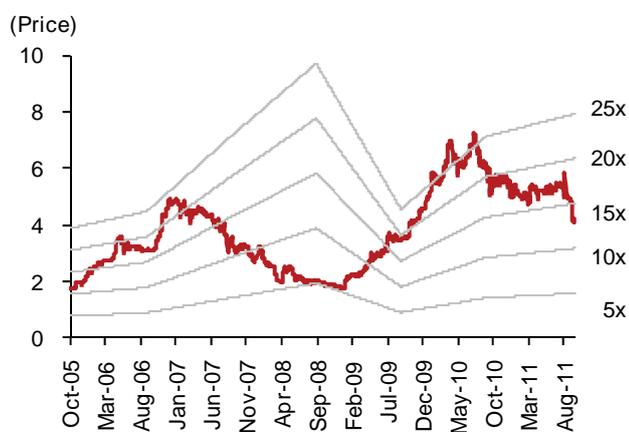
Source: Bloomberg, Nomura

**Fig. 96: Change in assumptions**

	New assumptions		Old assumptions	
	FY11F	FY12F	FY11F	FY12F
Latex price (MYR/ kg)	9.5	8.5	9.0	8.0
MYR/ USD	2.9	2.77	3.3	3.3
Revenue growth (%)	8.8	9.3	10.2	9.1
Earnings growth (%)	(53.1)	56.3	(17.7)	11.1
EBITDA margin (%)	8.9	11.8	13.7	14.0
Net margin (%)	5.1	7.3	8.8	9.0

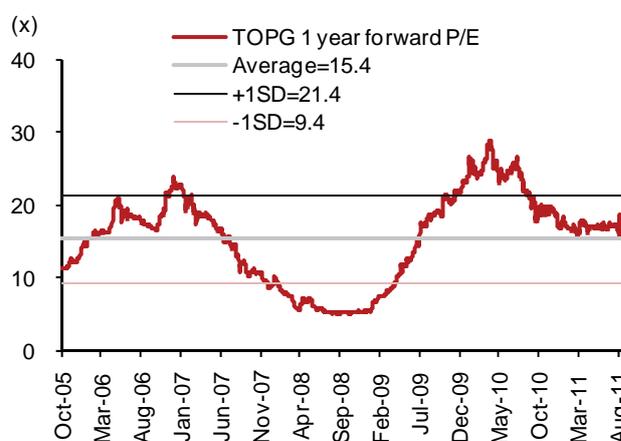
Source: Bloomberg, Nomura estimates

**Fig. 97: Top Glove – P/E Band**



Source: Bloomberg, Nomura ^y-axis denotes share price in RM

**Fig. 98: Top Glove – P/E Chart**



Source: Bloomberg, Nomura ^y-axis denotes P/E multiple

**Valuation Methodology and Risks**

We peg our FY12F diluted EPS of RM0.28 at a 12x target multiple, below the stock's seven-year average of 15.6x owing to current macro conditions, to arrive at our target price of RM3.42. Upside risks include: 1) a sharp easing of latex prices; 2) an appreciable demand rebound from FY12F, and; 3) Top Glove making a value-enhancing acquisition.

# Scenario analysis: What if the US and Europe slip back into recession?

As the markets have been signaling that risks to our baseline forecasts are on the downside, our global economics team have considered a bear case economic scenario.

This is most obviously triggered by a market meltdown, but the fragile state of the advanced economies leaves them vulnerable to unforeseen shocks or policy errors. For details, see *Global Weekly Economic Monitor*, 12 August 2011, and *Global market turbulence: Implications for Asia*, 9 August 2011. The bear case scenario assumes:

- The US and Euro area slip back into recession, with US GDP averaging -1% saar in 2H11 and Euro GDP averaging -3% before recovering to around 2% growth in 2012.
- The CRB commodity price index falls 15% between now and year-end, but starts rising back again through 2012 reaching current levels by end-2012.

If there is a market meltdown and recessions in the US and Euro area, we have no doubt that initially many economies in the region would be hit hard again in an echo of the global financial crisis, as non-linear effects start to kick in, notably financial decelerator effects, multiplier effects of weakening exports on domestic capex and jobs, and capital flight. However, less disturbing this time around are the two factors that there is less leverage in the financial system (less room for capital flight) and less chance of Asian trade finance drying up, as the world's central banks have most likely learnt the need to provide ample USD liquidity through FX swap arrangements.

In this scenario, we find Hong Kong, Singapore, Malaysia and Taiwan to be among the most vulnerable. But, as in 2009, we would expect that, over time, powerful tailwinds would develop, allowing Asia to bounce back before other regions. These tailwinds include a likely further decline in commodity prices and the ample room Asia has to ease monetary and fiscal policies – more so than any other region. In our bear case scenario, we would expect the Fed to resort to further quantitative easing, which once again would likely precipitate strong net capital inflows into Asia, attracted by stronger growth, superior fundamentals and higher interest rates relative to other regions.

What if things get even worse than we can foresee? Although our global economics team does not see such a situation as plausible at the moment, they have run an extreme-case scenario analysis to provide some perspective. This extreme scenario assumes:

- US GDP averaging about -4% saar in 2H11 and Euro GDP averaging -6.5% before recovering to around 1% growth in 2012.
- CRB commodity price index falls 40% between now and year-end, and stays at the lower level through 2012.

**Fig. 99: Real GDP growth forecasts: baseline and downside scenarios**

	2011F			2012F		
	Base case	Bear case	Extreme case	Base case	Bear case	Extreme case
Australia	2.2	1.5	0.9	4.6	3.5	3.3
China	9.5	9.0	8.5	8.6	8.8	6.0
Hong Kong	5.4	4.4	3.4	4.5	4.0	1.2
India	7.7	7.0	6.5	7.9	7.6	7.0
Indonesia	6.5	6.0	4.8	7.0	6.8	4.0
Malaysia	4.7	4.0	1.0	5.1	4.8	(0.4)
New Zealand	2.2	1.8	1.4	3.5	3.5	3.3
Philippines	5.1	4.7	3.3	5.7	5.3	2.4
Singapore	5.6	4.3	1.5	5.3	5.1	(1.8)
South Korea	3.5	2.5	1.5	5.0	5.0	2.5
Taiwan	4.5	3.6	2.4	5.0	4.9	0.9
Thailand	4.1	3.5	0.6	4.7	4.5	(0.5)
Vietnam	6.4	6.0	4.5	6.9	6.5	4.2
Asia ex Japan, Aus, NZ	7.9	7.2	6.4	7.6	7.6	5.1

Source: CEIC and Nomura Global Economics. Units: % y-y

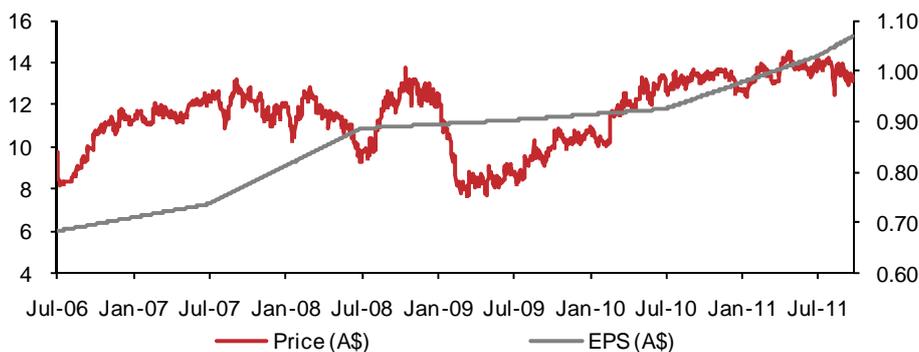
Less disturbing this time around are the two factors that there is less leverage in the financial system

The global bear case does not look bad for much of Asia and in fact is marginally better than the base case for China in 2012 because we would expect a V-shape rebound for the region thanks to the likely decline in commodity prices and the ample room Asia has to ease monetary and fiscal policies. We would also expect the Fed to resort to further quantitative easing, which once again would likely precipitate strong net capital inflows into Asia. In the extreme case, however, even these strengths will be tested.

## What does this mean for Ansell?

Over the six months from November 2008 to April 2009, Ansell's share price fell by 40.5%, in anticipation of softening industrial demand. ANN's key exposure to the global economic crisis was through softening demand for its industrial gloves, which are sold to a wide range of manufacturing industries across over 100 countries. During this time ANN's industrial division, which is forecast to contribute approximately half of ANN's FY12F EBIT, experienced a period of inventory de-stocking. Interestingly the financial impact to ANN's earnings only really emerged in the second half of the 2009 financial accounts, and was not evident in FY10. We believe the stimulus packages of various governments around the world had a positive impact in FY10.

**Fig. 100: ANN price vs EPS during GFC**



Source: Nomura estimates, FactSet share price data

We have conducted a scenario analysis to assess the possible impact on Ansell's earnings and target price in the bear and extreme cases, all other things being constant. Given that ANN's earnings are geographically dispersed, we have focussed on the sales volume growth in the industrials division. In order to do this, we have assumed the industrials volume growth falls to FY08 levels in the bear case and FY09 levels in the extreme case. The earnings and target price sensitivity is shown in the figure below.

The financial impact to ANN's earnings only really emerged in the second half of the 2009 financial accounts, and was not evident in FY10

**Fig. 101: Earnings and target price sensitivity for Ansell**

	Base case	Bear case	Downside (%)	Extreme case	Downside (%)
2012F EPS (US cps)	109.4	103.5	(5.4)	95.4	(12.8)
2013F EPS (US cps)	125.8	118.8	(5.6)	109.1	(13.3)
12-m target price	\$15.25	\$14.47	(5.1)	\$13.40	(12.1)

Note: Base case represents our current forecasts and TP

Source: Nomura estimates

## What does this mean for the Malaysian glovemakers – Top Glove, Supermax, Kossan?

The 2-year 2008-09 period happened to coincide with a sharp rise in latex prices to hit a historical peak (back then) of MYR7.20/kg (c5% above its past peak in 2006 of MYR6.85/kg) in 1H08, followed by a quick and steep fall back down to levels of MYR3+/kg in a span of a few months and stayed under MYR4/kg for most of 2009, as the global financial crisis took firm hold. Customers took opportunity to stock up on cheaper glove inventories arising from cheaper costs, given also zero to minimal capacity expansions as the glovemakers' held back capex plans during that period, most glove players experienced growing NPATs during the recession.

For the next 12 months, we think given what appears to be an easing (so far) of latex prices on the back of a commodities' correction, the driver that could have the most possible impact on EPS will likely be the demand topline impact. With capacity expansions of c15% still on track for FY12F versus single digit output growth currently, we run scenario analyses to illustrate a bear case scenario where output growth is zero

(ie revenue growth flat), and an extreme case where volumes are down 10% - as shown below (revenue down 10%).

**Fig. 102: Earnings and target price sensitivity for Top Glove**

(Currency)	Base case	Bear case	Downside %	Extreme case	Downside %
2012F EPS (RM cts / shr)	28.46	26.16	(8)	23.55	(17)
2013F EPS (RM cts / shr)	31.56	30.97	(2)	27.87	(12)
12-m target price	3.42	3.14	(8)	2.83	(17)

Note: Base case represents our current forecasts and TP. TP base d on 2012F EPS given only 2 quarters left to end 2011

Source: Nomura estimates

**Fig. 103: Earnings and target price sensitivity for Supermax**

(Currency)	Base case	Bear case	Downside %	Extreme case	Downside %
2012F EPS (RM cts / shr)	44.44	42.24	(5)	38.01	(14)
2013F EPS (RM cts / shr)	50.80	46.49	(8)	41.84	(18)
12-m target price	2.88	2.75	(5)	2.47	(14)

Note: Base case represents our current forecasts and TP. TP base d on 2012F EPS given only 2 quarters left to end 2011

Source: Nomura estimates

**Fig. 104: Earnings and target price sensitivity for Kossan Rubber**

(Currency)	Base case	Bear case	Downside %	Extreme case	Downside %
2012F EPS (RM cts / shr)	38.65	34.10	(12)	30.69	(21)
2013F EPS (RM cts / shr)	39.51	38.83	(2)	34.95	(12)
12-m target price	2.51	2.22	(12)	1.99	(21)

Note: Base case represents our current forecasts and TP. TP base d on 2012F EPS given only 2 quarters left to end 2011

Source: Nomura estimates

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# Appendix A-1

## Analyst Certification

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## Issuer Specific Regulatory Disclosures Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Ansell	ANN AU	AUD 12.99	26-Sep-2011	Buy	Not rated	
Kossan Rubber Industries	KRI MK	MYR 2.56	26-Sep-2011	Neutral	Not rated	
Supermax Corp Bhd	SUCB MK	MYR 2.36	26-Sep-2011	Buy	Not rated	
Top Glove Corp	TOPG MK	MYR 4.01	26-Sep-2011	Reduce	Not rated	

## Previous Rating

Issuer name	Previous Rating	Date of change
Ansell	Neutral	27-Sep-2011
Kossan Rubber Industries	Buy	27-Sep-2011
Supermax Corp Bhd	Not Rated	10-Mar-2010
Top Glove Corp	Neutral	27-Sep-2011

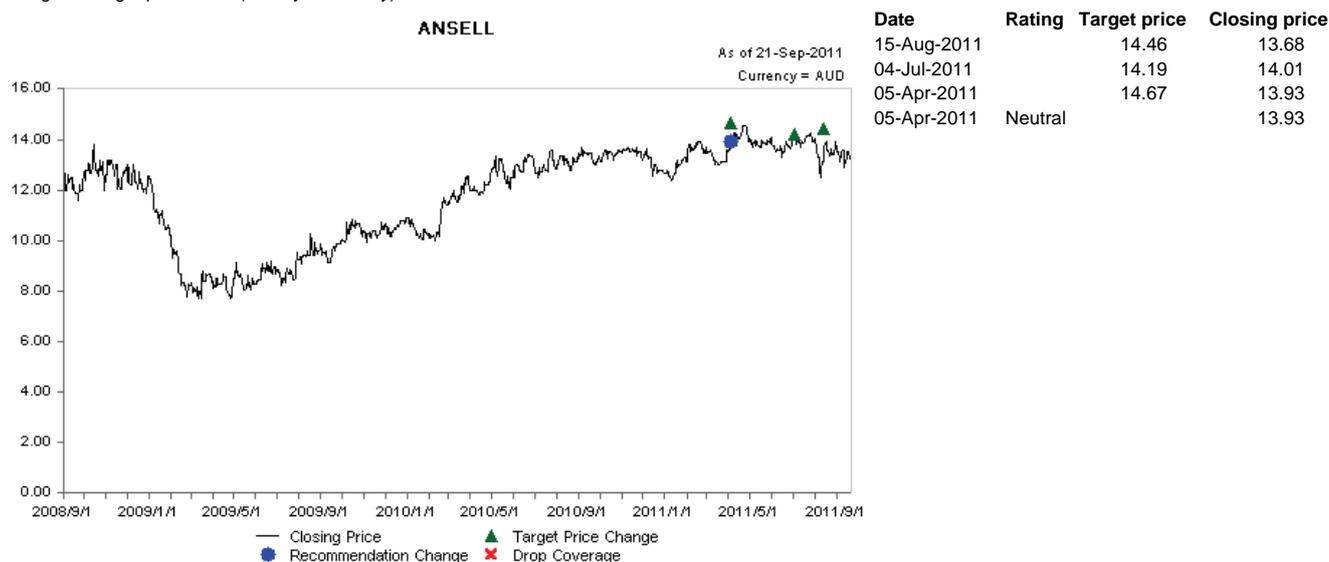
## Rating and target price changes

	Ticker	Old stock rating	New stock rating	Old target price	New target price
Ansell	ANN AU	Neutral	Buy	AUD 14.46	AUD 15.25
Kossan Rubber Industries	KRI MK	Buy	Neutral	MYR 4.76	MYR 2.51
Supermax Corp Bhd	SUCB MK	Buy	Buy	MYR 7.00	MYR 2.88
Top Glove Corp	TOPG MK	Neutral	Reduce	MYR 5.00	MYR 3.42

### Ansell (ANN AU)

**AUD 12.99 (26-Sep-2011)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We use a blend of three valuation methodologies to derive our AUD15.25 valuation for ANN: discounted cashflow analysis (DCF), a capitalisation of EV/EBITDA (10.7x FY12F) and normalised P/E multiples (14.9x FY12F). We believe this approach is appropriate for ANN because it has a number of listed competitors. As a result, each division's

relative value in the market can be readily ascertained. We use a P/E valuation, as it is a market standard, and an EV/EBITDA valuation metric, as this is frequently used in the global healthcare sector.

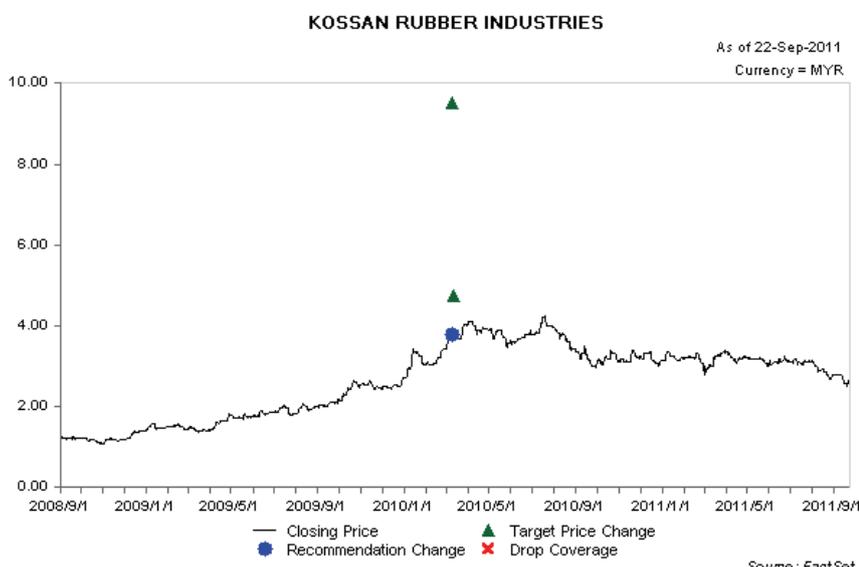
**Risks that may impede the achievement of the target price** Upside risks include higher-than-expected volume growth driven by emerging markets and an increase in industrial production activity; an announcement of an earnings-accretive acquisition. Downside risks include pressure on costs from rising prices of raw material inputs and a slowdown in the global economic recovery.

**Kossan Rubber Industries (KRI MK)**

**MYR 2.56 (26-Sep-2011)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)

Date	Rating	Target price	Closing price
12-Mar-2010		4.76	3.74
10-Mar-2010		9.51	3.80
10-Mar-2010	Buy		3.80



For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We peg Kossan's target price to a 6.5x FY12F P/E multiple. Applied to our FY11F EPS of RM0.39, we arrive at our target price of RM2.51.

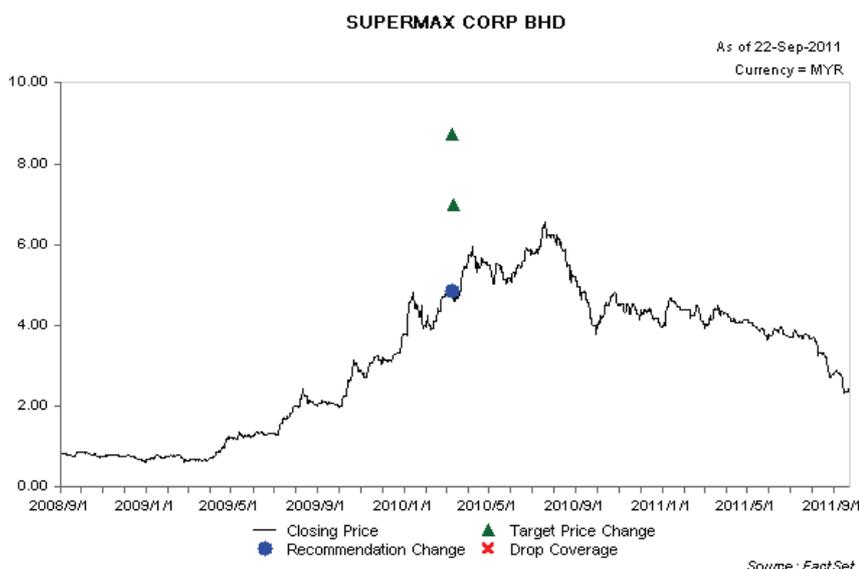
**Risks that may impede the achievement of the target price** Potential downside to our view includes delays / hiccups to the new product launch, which could affect Kossan's strategy to gain market share from other nitrile players and the higher-end segment. Upside risks include sharp easing of latex prices and appreciable demand rebound from FY12E.

**Supermax Corp Bhd (SUCB MK)**

**MYR 2.36 (26-Sep-2011)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)

Date	Rating	Target price	Closing price
12-Mar-2010		7.00	4.59
10-Mar-2010		8.74	4.84
10-Mar-2010	Buy		4.84



For explanation of ratings refer to the stock rating keys located after chart(s)

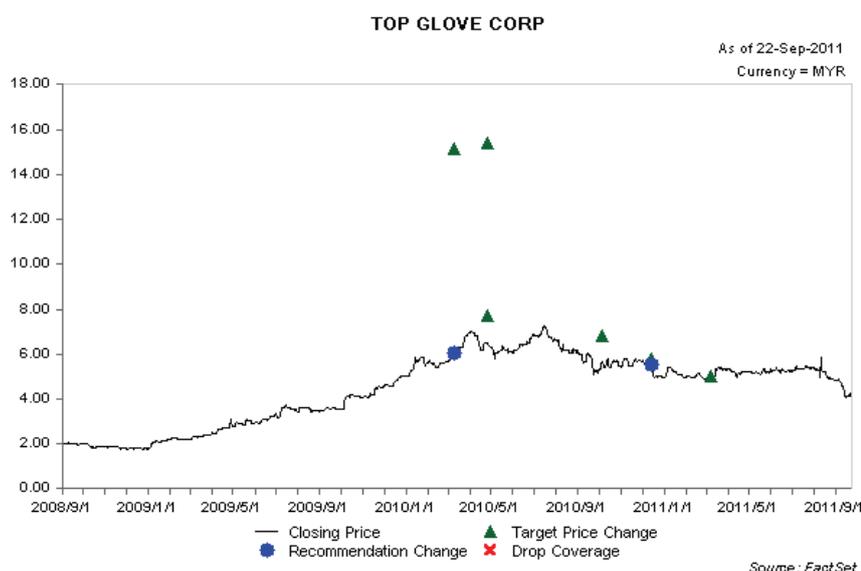
**Valuation Methodology** We peg Supermax's target P/E at 6.5x following market-multiple compressions. Post-APLI, P/E valuations have ranged from 6x to 16x. Applying this to FY12F EPS of RM0.44, we derive our target price of RM2.88.

**Risks that may impede the achievement of the target price** Downside risks to our target price include industry-related factors similar to those facing Top Glove, as well as adverse and rapid currency movements that could affect income from the company's overseas distribution arms.

**Top Glove Corp (TOPG MK)**

**MYR 4.01 (26-Sep-2011)** Reduce (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
09-Mar-2011		5.00	4.89
13-Dec-2010	Neutral	5.80	5.56
06-Oct-2010		6.82	5.69
27-Apr-2010		7.71	6.48
26-Apr-2010		15.42	6.49
10-Mar-2010		15.16	6.07
10-Mar-2010	Buy		6.07

For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We peg our FY12F diluted EPS of RM0.28 at 12x target multiple, below the stock's seven-year average of 15.6x owing to the current macro conditions, to arrive at the target price of RM3.42.

**Risks that may impede the achievement of the target price** Upside risks: 1) sharp easing of latex prices; 2) appreciable demand rebound from FY12F, and; 3) Top Glove making a value-enhancing acquisition.

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A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.

A rating of '**Suspended**', indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including, but not limited to, when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.

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### Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

#### STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as  $(\text{Target Price} - \text{Current Price}) / \text{Current Price}$ , subject to limited management discretion. In most cases, the Target Price will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc.

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A **'Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

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#### STOCKS

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A **'Buy'** recommendation indicates that upside is between 10% and 20%.

A **'Neutral'** recommendation indicates that upside or downside is less than 10%.

A **'Reduce'** recommendation indicates that downside is between 10% and 20%.

A **'Sell'** recommendation indicates that downside is more than 20%.

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