

05 June 2012

# Rubber Glove

**Neutral**


## Trading opportunities ahead?

There have been favourable movements in the latex price and currency exchange rate (RM to USD) recently, which if sustained, could be a boost to the industry players as we estimate that these players could see their net profit boosted by around 11-27%. The scenario could present trading opportunities on the glove counters, particularly for Top Glove Corporation ("TOPGLOV"), Supermax Corporation ("SUPERMX") and Kossan Rubber Industries ("KOSSAN"), which have the most exposure to natural latex glove production. We will be monitoring the above developments and will review our ratings and target prices should the downward movements be sustained although it's too early to make a definitive conclusion at this stage. Our top trading picks for this scenario are TOPGLOV (UP; TP: RM3.74), SUPERMX (MP; TP: RM2.06) and KOSSAN (OP; TP: RM3.64). The other players like Hartalega Holdings ("HARTA"; MP; TP: RM3.12) and Adventa Bhd ("ADVENTA"; UP; TP: RM1.41) will also probably see some trading interest as well.

**Price of latex is down.** In our previous sector report, we mentioned that industry players were expecting latex prices to ease and stabilise at a lower price from the peak earlier this year as these players were of the opinion that there were actually no shortages in the natural rubber latex supply since there was actually an ample supply of natural rubber coming from the additional plantations in neighboring countries like Cambodia and South Vietnam. Furthermore, latex traders were then expected to release their stocks to unlock their cash flow, which would have continued to suppress the latex prices. True enough, over the past two months, there was a downtrend in latex prices. Since the price peaked during the wintering season (around Feb-April 2012), it has currently fallen 12% from its highs. We expect prices to stabilise at this stage at c.RM7.00/kg as we reckon that the price would be monitored and supported by Thailand from falling further even despite the supply being sufficient.

**Sensitivity analysis on the latex price.** Based on our latex price assumption of RM7.00/kg, our sensitivity analysis (see Chart 3) shows that should the latex price ease further by 25 sen, most of the natural glove players could see a boost to their earnings by another 11-27% depending on the size of their exposure to latex usage. Note here that HARTA will not see much impact to its earnings given its substantial exposure to the nitrile glove segment. The continuing downtrend of the latex price will be a boon to the glove players, particularly those with significant exposure to the production of natural latex gloves (with potential earnings boost in the range of 11-27% for every 25 sen drop in latex prices as highlighted above). That said, we noted that glove players have recently move to super-thin gloves (3.5g), which is similar or in line with nitrile powder free gloves, and this would further reduce the consumption of natural rubber latex. Meanwhile, overall demand growth for gloves still remains healthy, allowing glove makers to continue being price makers and passing on any cost increases to customers.

**Currency impact.** Aside from the favourable latex price, we also see a stronger USD against MYR as USD has appreciated by 7% to RM3.19/USD currently from its low of RM2.99/USD early this year. As the USD strengthens, we expect some positive impact to the glove makers' bottom lines as more than 90% of their sales are exports sales. Based on our sensitivity analysis (as per Chart 4), the glovemakers should see an earnings accretion of 5-15% for every 1% appreciation in the USD to MYR. Our earnings projection is based on our in-house USD/MYR projection of RM2.85/USD and RM2.95/USD for FY12 and FY13. In fact, there should be an earnings accretion of 5-29% should the USD/MYR remains at the current level of RM3.10/USD.

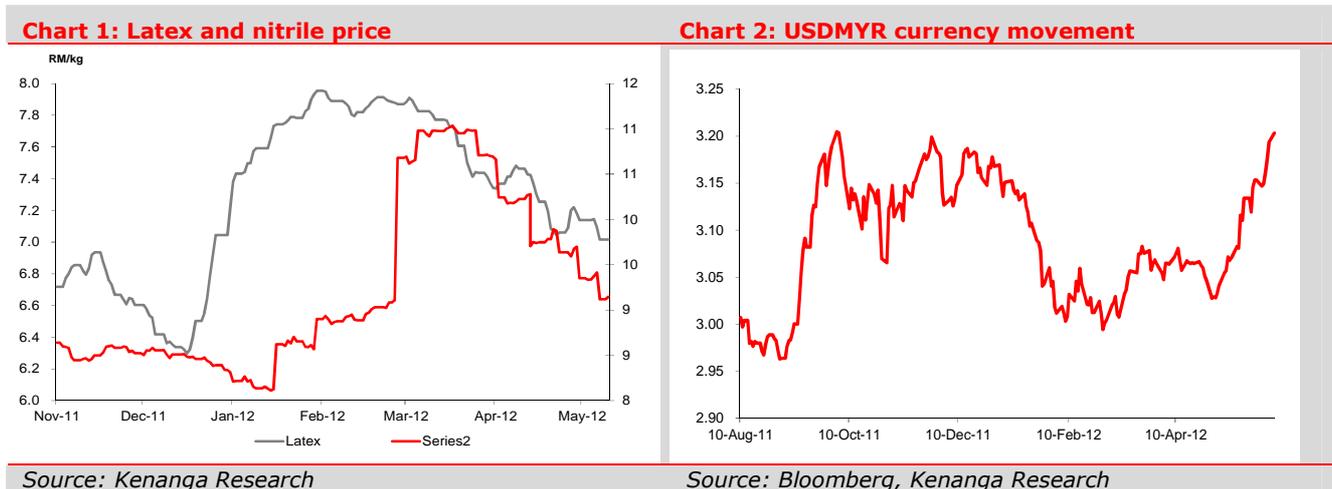
**Maintain Neutral.** We could see a potential margin expansion on the glove counters in the quarters ahead should the latex price and the USD/MYR currency pair trend further down. The scenario could present trading opportunities on the glove counters particularly for TOPGLOV, SUPERMX and KOSSAN, which have the most exposure to natural latex glove production. We will be monitoring the above developments and will review our ratings and target prices should the downward movements be sustained although it's too early to make a definitive conclusion at this stage. Our top trading picks for this scenario are TOPGLOV, SUPERMX and KOSSAN. The other players like HARTA and ADVENTA will also probably see some trading interest as well.




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**The Research Team**  
[research@kenanga.com.my](mailto:research@kenanga.com.my)  
 Tel: 603-2713 2292

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**Chart 3: Sensitivity analysis on the latex price changes**

Sensitivity to Latex	50sen	25sen	*Base case	-25sen	-50sen
<b>Kossan (FY12) RMm</b>	93.8	106.5	119.2	132.0	144.7
% impact on profit	-21%	-11%	0%	11%	21%
<b>Supermax (FY12) RMm</b>	99.3	113.2	127.2	141.1	155.0
% impact on profit	-22%	-11%	0%	11%	22%
<b>Top Glove (FY13) RMm</b>	80.1	125.6	171.2	216.7	262.3
% impact on profit	-53%	-27%	0%	27%	53%
<b>Hartalega (FY13) RMm</b>	233.1	235.1	237.1	239.1	241.1
% impact on profit	-2%	-1%	0%	1%	2%

Source: Bloomberg

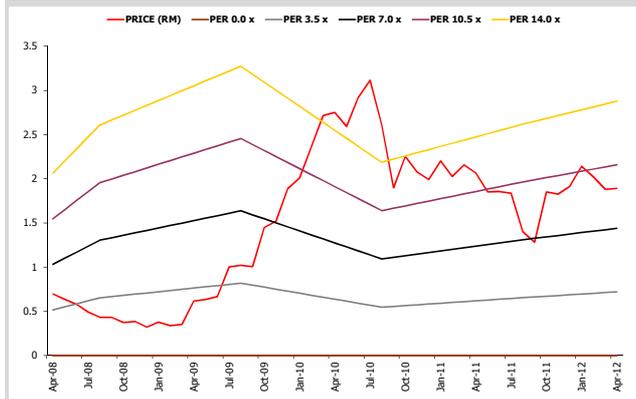
**Chart 4: Sensitivity analysis on the USD-MYR currency changes**

Sensitivity to USD	-3%	-2%	-1%	*Base case	+1%	+2%	+3%
<b>Kossan (FY12) RMm</b>	80.2	93.2	106.2	119.2	132.3	145.3	158.3
% impact on profit	-33%	-22%	-11%	0%	11%	22%	33%
<b>Supermax (FY12) RMm</b>	93.0	104.4	115.8	127.1	138.5	149.9	161.3
% impact on profit	-27%	-18%	-9%	0%	9%	18%	27%
<b>Top Glove (FY13) RMm</b>	97.1	122.0	147.0	172.0	197.0	222.0	247.0
% impact on profit	-44%	-29%	-15%	0%	15%	29%	44%
<b>Hartalega (FY13) RMm</b>	203.8	214.9	226.0	237.1	248.2	259.3	270.4
% impact on profit	-14%	-9%	-5%	0%	5%	9%	14%

\*Base case as per our economist projection whereby our forecast for FY12 is RM2.95/USD and FY13 is RM2.85/USD

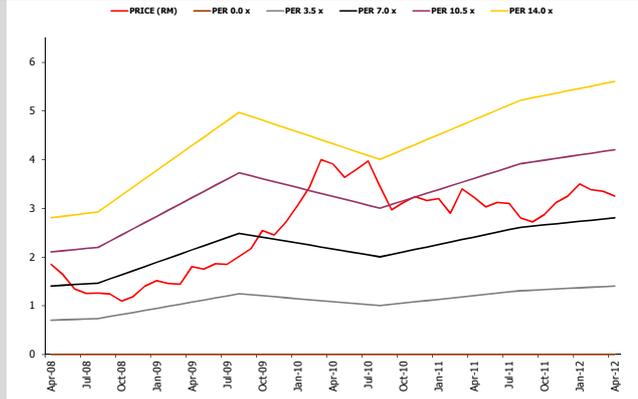
Source: Bloomberg

**Chart 5: Supermax forward PER**



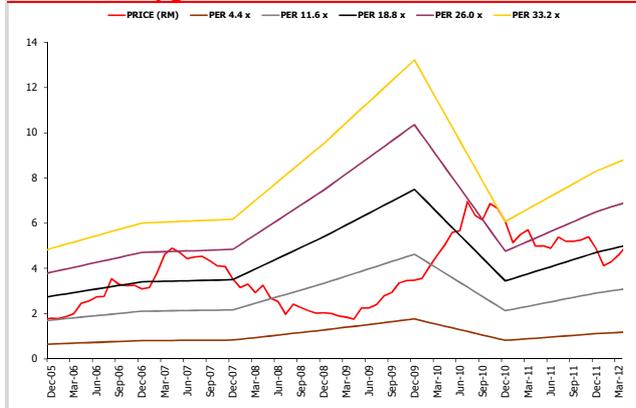
Source: Kenanga Research

**Chart 2: Kossan forward PER**



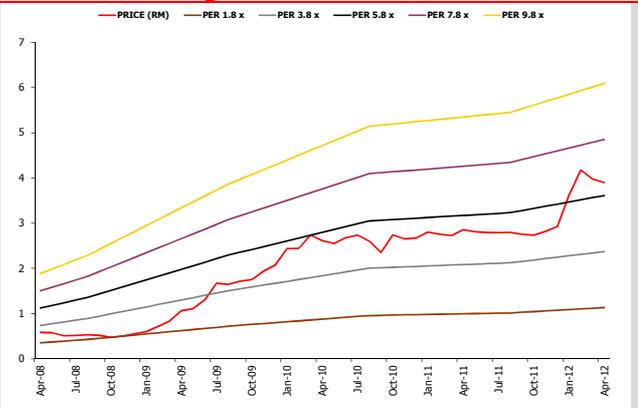
Source: Bloomberg

**Chart 1: Topglove forward PER**



Source: Kenanga Research

**Chart 2: Hartalega forward PER**



Source: Bloomberg

**Stock Ratings are defined as follows:**

**Stock Recommendations**

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

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

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

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

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**KENANGA INVESTMENT BANK BERHAD (15678-H)**

8th Floor, Kenanga International, Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia  
Telephone: (603) 2166 6822 Facsimile: (603) 2166 6823 Website: [www.kenangaresearch.com](http://www.kenangaresearch.com)



Chan Ken Yew  
Associate Director