

## Healthcare Products - Rubber Gloves

**Overweight** (Maintained)

### Set To Bounce

Macro    
 Risks    
 Growth    
 Value  

We are optimistic on the rubber glove sector as market conditions are tilting in favour of glove makers. We are **OVERWEIGHT** on the sector owing to: i) favourable raw material prices, (ii) the strengthening USD, (iii) minimal impact from a potential natural gas cost hike, and (iv) resilient gloves demand. We have **BUY** calls for Hartalega, Top Glove, Kossan and Supermax.

- ◆ **Results in line.** Of the four companies under our coverage, three recorded healthy June quarter earnings, which came largely in line with our expectations. The numbers were bolstered by softening raw material prices and rising production capacity. However, Top Glove reported disappointing results in the quarter ended May (FYE Aug) due to a shift in demand from natural rubber (NR) gloves to nitrile gloves.
- ◆ **Favourable raw material prices and currency.** We believe the 14.2% YTD decline in raw material prices and the strengthening of the USD to MYR3.30 in Aug 2013 from MYR3.05 in Jan 2013 would bolster glove makers' earnings margins moving forward.
- ◆ **Natural gas hike to have minimal impact.** We believe that a potential hike in natural gas will have a minimal impact on glove makers as energy costs only make up 8% to 10% of total production costs. Glove makers can use biomass energy to mitigate the increase in energy costs.
- ◆ **Glove demand still resilient.** We believe that rubber gloves demand will remain intact over the next few years due to a shift in preference towards synthetic nitrile gloves. Shipments of nitrile gloves to the US surged to 31.8bn pieces in 2012 from just 5.3bn pieces in 2003.
- ◆ **Maintain OVERWEIGHT.** We continue to like the rubber gloves sector as the operating environment is turning favourable. Thus, we have BUY recommendations for Hartalega (HART MK, FV: MYR7.95), Top Glove (TOPG MK, FV: MYR7.08), Kossan (KRI MK, FV: MYR7.53) and Supermax (SUCB MK, FV: MYR3.01).

Company Name	Price	Target	P/E (x)	P/B (x)	Yield (%)	Rating
			Dec-13F	Dec-13F	Dec-13F	
Hartalega	MYR7.04	MYR7.95	19.6	5.8	2.3	BUY
Kossan Rubber Industries	MYR6.78	MYR7.53	15.0	3.1	2.0	BUY
Supermax	MYR2.71	MYR3.01	12.4	1.9	2.4	BUY
Top Glove	MYR6.20	MYR7.08	17.2	2.6	1.9	BUY

Source: Company data, RHB estimates

The Research Team +603 9207 7688  
[Research2@rhbgroup.com](mailto:Research2@rhbgroup.com)

**2QFY13 results in line.** The rubber gloves sector registered healthy results for the quarter ended June that were well within our expectations. Three of the four rubber glove stocks under our coverage - Hartalega, Kossan and Supermax - delivered commendable 1HFY13 bottomlines, mostly boosted by easing prices of raw materials such as natural rubber latex and nitrile, as well as rising production capacity. However, Top Glove (FYE Aug) came in below our expectations, mainly attributed to lower demand for its latex gloves as customers shifted to nitrile, which led to pricing pressure for natural rubber (NR) gloves.

**Capacity expansion to drive earnings.** Going forward, we expect the glove companies' expansion plans to propel earnings growth. Both Kossan and Supermax are focusing more on the higher-margin nitrile glove segment, targeting to increase their nitrile capacity by 1.4bn pieces and 6.4bn pieces by end-2013 respectively.

**Favourable natural latex prices.** As natural latex price eases, we believe that natural rubber glove makers will be able to maintain healthy earnings margins. Natural latex prices have dropped 14.2% YTD to MYR5.23/kg currently. Going into 2HFY13, we expect natural latex price to consolidate within the MYR4.50-5.50/kg range on the back of rising supply from Thailand and Cambodia, softer auto sales growth in China, as well as slowing demand for natural latex amid a sluggish global economy.

**Figure 1: Monthly latex price movement (MYR sen/kg)**



Source: Malaysian Rubber Board

**Figure 2: Sensitivity analysis for increase in latex prices**

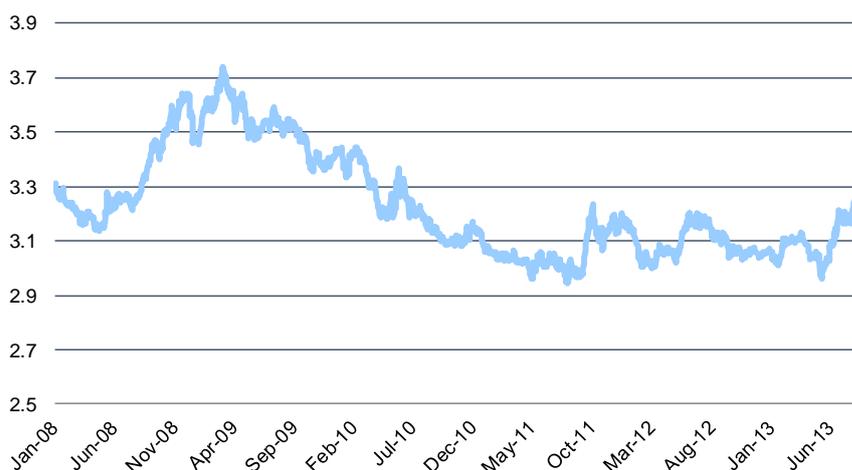
Company	Ticker	Net profit (MYR m)	Latex price/kg	Variance (%)
		FY14f	+MYR0.50	
Top Glove	TOPG MK	257.5	163.6	-36.5%
Hartalega	HART MK	270.2	229.7	-15.0%
Kossan	KRI MK	172.6	133.1	-22.9%
Supermax	SUCB MK	166.6	141.4	-15.1%

Source: RHB estimates

**Nitrile prices easing too.** The price of nitrile latex, which is made up of nitrile butadiene rubber and other chemicals, has also fallen, easing to MYR4.03 per kg in July 2013 from MYR5.54 per kg in Jan 2013. This is good for all the rubber glove players as most of them are ramping up nitrile gloves production. We expect nitrile prices to remain at these levels, thus allowing nitrile glove makers to maintain wholesome margins going forward.

**Strengthening USD a short-term positive.** Currently, the MYR - along with other emerging market currencies - has weakened against the USD as investors redirect their investments to the US following the Federal Reserve's announcement to taper off its quantitative easing programme. The MYR is now trading at about MYR3.30 to the USD, down 8.2% YTD. A stronger USD vis-à-vis the MYR benefits glove makers as most of their products' ASPs are denominated in dollars. That said, we believe the positive impact would be short term as glove makers regularly hedge against currency fluctuations, which should smoothen out any positive or negative impact.

**Figure 3: Monthly USD/MYR price movement**



Source: Bloomberg

**Figure 4: Sensitivity analysis for an increase in USD/MYR**

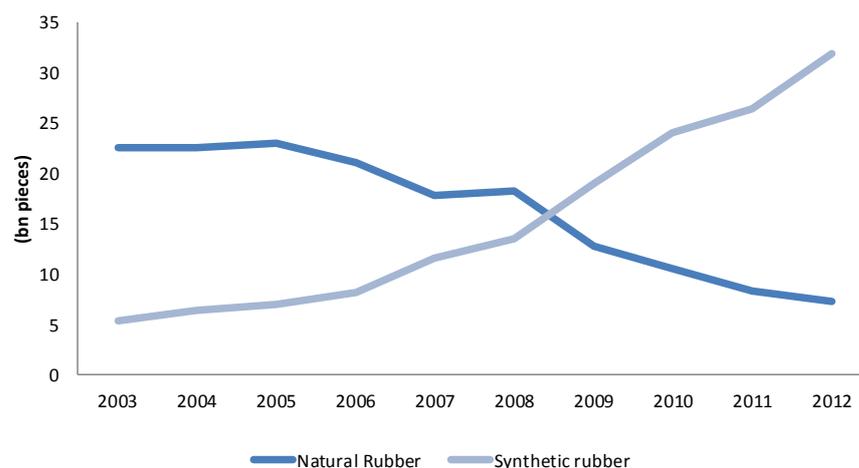
Company	Ticker	Net profit (MYR m) FY14f	USD/MYR +MYR0.10	Variance (%)
Top Glove	TOPG MK	257.5	311.5	21%
Hartalega	HART MK	270.2	295.7	9%
Kossan	KRI MK	172.6	199.6	16%
Supermax	SUCB MK	166.6	184.6	11%

Source: RHB estimates

**Gas price to go up?** This month, the Malaysian Government raised petrol prices in what is seen as a first step to rationalize its subsidies, with more fiscal consolidation measures likely to be proposed in its 2014 Budget. We believe that glove makers may potentially face higher production costs from an increase in energy prices. Natural gas price was first raised to MYR13.70/mmbtu (million metric British thermal units) from MYR10.70/mmbtu in June 2011, followed by a gradual increase of MYR3.00/mmbtu every six months until it reaches market parity in 2016. However, there has been no further progress since the last assessment in Dec 2011. That said, we believe that the impact of higher gas prices on glove makers will be minimal as energy costs only make up about 8-10% of their total production costs. In addition, glove makers can mitigate the impact by using biomass energy as an alternative to natural gas.

**Glove demand to stay resilient.** We expect the annual demand for rubber gloves to remain steady at 10% growth over the next few years, mainly driven by solid demand for nitrile-based gloves, although we expect latex-based gloves to continue to chalk up positive sales growth as raw material prices eases. The shipment of synthetic gloves to the US surged to 60.9% in 2012 from 16% in 2003. According to glove makers, utilisation rates for nitrile production stand at 85-90%, with oversold positions of up to 90 days. This means that capacity is ordered at least three months in advance.

**Figure 5: US glove imports trend from 2003 – 2012**



Source: RHB, Hartalega

**All-round capacity expansion.** As demand increasingly shifts to synthetic gloves, glove makers are responding by boosting their capacity for nitrile production. Hartalega is building its next-generation integrated glove manufacturing complex (NGC), with its first line expected to begin construction in Aug 2014. This will bolster its overall capacity to 43bn pieces in 2020. Meanwhile, Top Glove plans to increase its nitrile glove production capacity to 47.9bn pieces annually (from 41.9bn pieces). As of June 2013, the company's production mix comprised 73% natural latex and 18% nitrile.

In the meantime, Kossan and Supermax are also bolstering their nitrile gloves production capacity. Upon completion in May 2014, Kossan's annual production capacity will go up by 31% to 22bn pieces while Supermax's nitrile capacity will more than double its annual capacity to 12.3bn pieces by 1QFY14. We are positive on nitrile expansion as nitrile demand is set to rise at 18-20% annually.

**Maintain OVERWEIGHT.** Given the current market conditions, we are revising our assumptions for all four companies under our coverage to incorporate the strengthening USD vs MYR, as well as the latest hike in petrol prices in Malaysia. All said, the downtrend in raw material prices and strengthening USD reinforce our positive stance on the rubber gloves sector. We remain OVERWEIGHT on the sector, with BUY recommendations for Hartalega (HART MK, FV: MYR7.95), Top Glove (TOPG MK, FV: MYR7.08), Kossan (KRI MK, FV: MYR7.53) and Supermax (SUCB MK, FV: MYR3.01).

**Figure 6: Changes in fair value and net profits**

	Fair Value (FV)		FY13 net profit (MYR m)		FY14 net profit (MYR m)	
	Old	New	Old	New	Old	New
Top Glove	7.01	7.08	204.5	205.2	255.2	257.5
Hartalega	8.04	7.95	235.0	235.0	267.9	270.2
Kossan	7.38	7.53	133.4	144.5	169.0	145.5
Supermax	2.84	3.01	137.9	144.6	156.9	166.6

Source: RHB estimates

## RHB Guide to Investment Ratings

- Buy:** Share price may exceed 10% over the next 12 months  
**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain  
**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months  
**Take Profit:** Target price has been attained. Look to accumulate at lower levels  
**Sell:** Share price may fall by more than 10% over the next 12 months  
**Not Rated:** Stock is not within regular research coverage

## Disclosure & Disclaimer

All research is based on material compiled from data considered to be reliable at the time of writing, but RHB does not make any representation or warranty, express or implied, as to its accuracy, completeness or correctness. No part of this report is to be construed as an offer or solicitation of an offer to transact any securities or financial instruments whether referred to herein or otherwise. This report is general in nature and has been prepared for information purposes only. It is intended for circulation to the clients of RHB and its related companies. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is for the information of addressees only and is not to be taken in substitution for the exercise of judgment by addressees, who should obtain separate legal or financial advice to independently evaluate the particular investments and strategies.

RHB, its affiliates and related companies, their respective directors, associates, connected parties and/or employees may own or have positions in securities of the company(ies) covered in this research report or any securities related thereto, and may from time to time add to, or dispose off, or may be materially interested in any such securities. Further, RHB, its affiliates and related companies do and seek to do business with the company(ies) covered in this research report and may from time to time act as market maker or have assumed an underwriting commitment in securities of such company(ies), may sell them or buy them from customers on a principal basis and may also perform or seek to perform significant investment banking, advisory or underwriting services for or relating to such company(ies), as well as solicit such investment, advisory or other services from any entity mentioned in this research report.

RHB and its employees and/or agents do not accept any liability, be it directly, indirectly or consequential losses, loss of profits or damages that may arise from any reliance based on this report or further communication given in relation to this report, including where such losses, loss of profits or damages are alleged to have arisen due to the contents of such report or communication being perceived as defamatory in nature.

The term "RHB" shall denote where applicable, the relevant entity distributing the report in the particular jurisdiction mentioned specifically herein below and shall refer to RHB Research Institute Sdn Bhd, its holding company, affiliates, subsidiaries and related companies.

All Rights Reserved. This report is for the use of intended recipients only and may not be reproduced, distributed or published for any purpose without prior consent of RHB and RHB accepts no liability whatsoever for the actions of third parties in this respect.

### Malaysia

This report is published and distributed in Malaysia by RHB Research Institute Sdn Bhd (233327-M), Level 11, Tower One, RHB Centre, Jalan Tun Razak, 50400 Kuala Lumpur, a wholly-owned subsidiary of RHB Investment Bank Berhad (RHBIB), which in turn is a wholly-owned subsidiary of RHB Capital Berhad.

### Singapore

This report is published and distributed in Singapore by DMG & Partners Research Pte Ltd (Reg. No. 200808705N), a wholly-owned subsidiary of DMG & Partners Securities Pte Ltd, a joint venture between Deutsche Asia Pacific Holdings Pte Ltd (a subsidiary of Deutsche Bank Group) and OSK Investment Bank Berhad, Malaysia which have since merged into RHB Investment Bank Berhad (the merged entity is referred to as "RHBIB", which in turn is a wholly-owned subsidiary of RHB Capital Berhad). DMG & Partners Securities Pte Ltd is a Member of the Singapore Exchange Securities Trading Limited. DMG & Partners Securities Pte Ltd may have received compensation from the company covered in this report for its corporate finance or its dealing activities; this report is therefore classified as a non-independent report.

As of 8 September 2013, DMG & Partners Securities Pte Ltd and its subsidiaries, including DMG & Partners Research Pte Ltd, do not have proprietary positions in the securities covered in this report, except for:

a) -

As of 8 September 2013, none of the analysts who covered the securities in this report has an interest in such securities, except for:

a) -

### **Special Distribution by RHB**

Where the research report is produced by an RHB entity (excluding DMG & Partners Research Pte Ltd) and distributed in Singapore, it is only distributed to "Institutional Investors", "Expert Investors" or "Accredited Investors" as defined in the Securities and Futures Act, CAP. 289 of Singapore. If you are not an "Institutional Investor", "Expert Investor" or "Accredited Investor", this research report is not intended for you and you should disregard this research report in its entirety. In respect of any matters arising from, or in connection with this research report, you are to contact our Singapore Office, DMG & Partners Securities Pte Ltd.

### Hong Kong

This report is published and distributed in Hong Kong by RHB OSK Securities Hong Kong Limited ("RHBSHK") (formerly known as OSK Securities Hong Kong Limited), a subsidiary of OSK Investment Bank Berhad, Malaysia which have since merged into RHB Investment Bank Berhad (the merged entity is referred to as "RHBIB"), which in turn is a wholly-owned subsidiary of RHB Capital Berhad.

RHBSHK, RHBIB and/or other affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company. RHBSHK, RHBIB and/or other affiliates may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company.

## Risk Disclosure Statements

The prices of securities fluctuate, sometimes dramatically. The price of a security may move up or down, and may become valueless. It is as likely that losses will be incurred rather than profit made as a result of buying and selling securities. Past performance is not a guide to future performance. RHBSHK does not maintain a predetermined schedule for publication of research and will not necessarily update this report

### Indonesia

This report is published and distributed in Indonesia by PT RHB OSK Securities Indonesia (formerly known as PT OSK Nusadana Securities Indonesia), a subsidiary of OSK Investment Bank Berhad, Malaysia, which have since merged into RHB Investment Bank Berhad, which in turn is a wholly-owned subsidiary of RHB Capital Berhad.

### Thailand

This report is published and distributed in Thailand by RHB OSK Securities (Thailand) PCL (formerly known as OSK Securities (Thailand) PCL), a subsidiary of OSK Investment Bank Berhad, Malaysia, which have since merged into RHB Investment Bank Berhad, which in turn is a wholly-owned subsidiary of RHB Capital Berhad.

### Other Jurisdictions

In any other jurisdictions, this report is intended to be distributed to qualified, accredited and professional investors, in compliance with the law and regulations of the jurisdictions.

Kuala Lumpur	Hong Kong	Singapore
<p><b>Malaysia Research Office</b> RHB Research Institute Sdn Bhd Level 11, Tower One, RHB Centre Jalan Tun Razak Kuala Lumpur Malaysia Tel : +(60) 3 9280 2185 Fax : +(60) 3 9284 8693</p>	<p><b>RHB OSK Securities Hong Kong Ltd.</b> <b>(formerly known as OSK Securities Hong Kong Ltd.)</b> 12th Floor World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : +(852) 2525 1118 Fax : +(852) 2810 0908</p>	<p><b>DMG &amp; Partners Securities Pte. Ltd.</b> 10 Collyer Quay #09-08 Ocean Financial Centre Singapore 049315 Tel : +(65) 6533 1818 Fax : +(65) 6532 6211</p>
Jakarta	Shanghai	Phnom Penh
<p><b>PT RHB OSK Securities Indonesia</b> <b>(formerly known as PT OSK Nusadana Securities Indonesia)</b> Plaza CIMB Niaga 14th Floor Jl. Jend. Sudirman Kav.25 Jakarta Selatan 12920, Indonesia Tel : +(6221) 2598 6888 Fax : +(6221) 2598 6777</p>	<p><b>RHB OSK (China) Investment Advisory Co. Ltd.</b> <b>(formerly known as OSK (China) Investment Advisory Co. Ltd.)</b> Suite 4005, CITIC Square 1168 Nanjing West Road Shanghai 20041 China Tel : +(8621) 6288 9611 Fax : +(8621) 6288 9633</p>	<p><b>RHB OSK Indochina Securities Limited</b> <b>(formerly known as OSK Indochina Securities Limited)</b> No. 1-3, Street 271 Sangkat Toeuk Thla, Khan Sen Sok Phnom Penh Cambodia Tel: +(855) 23 969 161 Fax: +(855) 23 969 171</p>
Bangkok		
<p><b>RHB OSK Securities (Thailand) PCL</b> <b>(formerly known as OSK Securities (Thailand) PCL)</b> 10th Floor, Sathorn Square Office Tower 98, North Sathorn Road, Silom Bangrak, Bangkok 10500 Thailand Tel: +(66) 862 9999 Fax : +(66) 108 0999</p>		