Rubber Gloves | MALAYSIA

HEALTHCARE & PHARMACEUTICALS

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NEW THEME

Another good stretch

Even after a good run for Malaysian rubber glove stocks over the past 12 months, we think valuations are far from stretched, at FY11F P/Es of 7.8-11.6x, or 20-46% below the market's P/E of 14.5x. While most companies should see a breather after 40-50% EPS growth in 2009 spurred by pandemic fears, we expect a leg-up in structural demand growth, fuelled by recovery in the global economy, to support 9-26% EPS CAGRs over the next three years. For this growth story, P/Es of 7.8-11.6x for FY11F look compelling against the Malaysian market and other companies on Nomura's BUY list. Malaysian players control 60-65% of global capacity and we see three- to five-month backlogs and high latex prices driving higher ASPs in 2010F. Sizeable long-term potential exists in the largely untapped Asian markets, which make up just 6-10% of global sales, while concerns on potential industry overcapacity in 2011F seem premature given the global economic recovery and potential restrictions in natural gas supply. We initiate coverage on Top Glove, Kossan and Supermax, the three largest listed glove makers in the world, with BUY ratings. Our top pick is Top Glove, whose diversified global customer base should support stable margins and for which we forecast a three-year EPS CAGR of 25.7%, implying an FY11F P/E of 11.6x.

① A strong year ahead

② Too early to worry about industry glut

③ Malaysia — the largest glove producer in the world

④ P/Es still low for growth, Top Glove is our top pick

Nomura Anchor Reports examine the key themes and value drivers that underpin our sector views and stock recommendations for the next 6 to 12 months.

Stocks for action

Our top pick is Top Glove given its consistent track record in delivering growth and continued market leadership. We are also positive across the sector.

Stock	Rating	Price (RM)	Price target (RM)
Top Glove (TOPG MK)	BUY*	11.98	15.16
Supermax (SUCB MK)	BUY*	6.16	8.74
Kossan Rubber Industries (KRI MK)	BUY*	7.38	9.51

* Initiating coverage; prices as at 5 March close

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Action

Despite soaring an average of 300% (vs the market's 48% rise), leading rubber glove stocks still imply 25-40% upside, in our view. The risks of overcapacity and margin squeeze are unlikely to unfold in the next 12 months. Attractive valuations of up to a 46% discount to market P/E, coupled with strong earnings growth prospects over the next four quarters, support our investment calls.

Catalysts

Latent demand from China, India and possible US healthcare reform remain potential re-rating catalysts.

Anchor Themes

With no imminent risks, the glove sector looks set to benefit from another year of strong growth. Companies with exposure to faster-growing markets, diversified revenue bases and efficient cost structures are our top picks.

Stocks for action

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* Initiating coverage
Prices as at 5 March, 2010.

Another good stretch

① A strong year ahead

Supplier pricing power remains evident moving into 2010F, as demand stays strong. We see the current three-five month backlogs and high latex prices continuing to drive higher average selling prices in 2010F. Demand risk for the year remains minimal, in our view.

② Too early to worry about industry glut

Valuations are still at depressed levels, partly on concerns over potential industry overcapacity in 2011F. Such low valuations, we believe, are unwarranted; any potential glut should not happen before 2011F. At current low valuations, we believe demand assumptions by the Street have yet to reflect anticipated recovery in the US (our US team forecasts 3.1% growth in 2010F vs -2.4% in 2009, per our US Economic Weekly, 5 March, 2010) and global economies, driven by strong growth in emerging Asia. As such, it is too early to be concerned about industry overcapacity, in our view.

③ Malaysia — largest glove producer in the world

Malaysia controls 65% of global capacity, achieved through a combination of proximity to key raw materials, infrastructure, painstaking R&D, development of supporting industries and support from government agencies. This nexus has been two decades in the making and is a hard advantage to trump, in our view.

④ Valuing based on P/E

We value glove stocks using a P/E methodology, underpinned by strong earnings visibility. After 40-50% EPS growth in FY09E, we expect rubber glove companies to post between 9% and 26% EPS CAGRs over the next three years. At 7.8-11.6x FY11F, P/E valuations remain at compelling levels vs the market and other companies on Nomura's Buy list, in our view. Given Malaysia's market leadership in the global glove market, we think this presents a unique investment theme backed by strong earnings growth and reasonable valuations.

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Not too late to chase

Executive summary

The sector outperformed in a year marked by a change of fortune

Rubber glove stocks had an impressive run in 2009, with glove players such as Top Glove, Supermax and Kossan Rubber rising an average of 300% in the past 52 weeks on the back of double-digit FY09 earnings growth. This is compared to a 48% gain in the market.

We think sector names will still return 25-40% upside

We do not think it is too late to buy in, since we expect growth to continue, underpinned by a demand backlog and strengthened supplier power still evident moving into 2010F. Latex prices are hovering at 10-year highs, allowing glove players to justify high ASPs. All this translates to potential upside of 25-40% for our stocks.

Healthcare spending will be driven by reforms and by India and China's billions, who are growing more affluent

Positive re-rating catalysts stand via untapped demand from a growing middle-income segment in China and India and increased healthcare spending resulting from US healthcare reform, which imply further upside for our sector picks.

We don't think the glove makers will have forgotten the woes of overcapacity

While the risk of overcapacity in 2011F can not be dismissed, neither is it a certainty. The sector saw overcapacity back in 2001 and testimony to the phrase 'once bitten twice shy', glove players will be keeping a close eye on planned capacity expansion should there be a hint of oversupply, in our view.

This is one global industry where Malaysia's dominance is unparalleled

Malaysia's competitive advantage should continue to ensure it dominates the glove industry. And this advantage lies not only in its proximity to raw material; Malaysia's market leadership rests on two decades of nurturing the industry from its beginnings as a latex exporter to now supplying 65% of world demand for rubber gloves. Any nation will be facing an uphill climb to catch up with Malaysia anytime soon.

Glove sector players are expected to chalk up between 20% and 40% earnings growth in 2010F, compared to expected Malaysia market earnings growth of circa 15%. Backed by low valuations vis-à-vis other Malaysian stocks, discounts of 20-46% to the market P/E, and given the barriers to entry arising from local glove players' strong competitive advantages, the glove sector presents a unique Malaysia investment theme that rightfully bears testament to the oft-quoted phrase – "Malaysia Boleh".

Exhibit 1. Local and regional comparables

Companies	Ticker	Mkt cap (US$mn)	Curr.	Price (Loc)	Target price (Loc)	Rating	ROE (%) 2010F	ROE (%) 2011F	EPS gth (%) 2010F	EPS gth (%) 2011F	P/BV (x) 2010F	P/BV (x) 2011F	P/E (x) 2010F	P/E (x) 2011F
Malaysia Glovemakers														
Top Glove	TOPG MK	1,095	RM	11.98	15.16	BUY	27.3	29.1	45.6	26.4	3.7	3.1	14.7	11.6
Supermax	SUCB MK	497	RM	6.16	8.74	BUY	26.8	25.8	25.0	20.7	2.3	1.9	10.0	8.3
Kossan	KRI MK	350	RM	7.38	9.51	BUY	27.8	29.0	(5.5)	33.9	2.6	2.0	10.4	7.8
Hartalega	HART MK	522	RM	7.30	-	Not Rated	39.9	34.4	74.2	18.1	4.8	3.6	13.6	11.5
Latexx Partners	LTX MK	241	RM	4.03	-	Not Rated	46.5	40.4	94.7	27.0	n/a	n/a	10.9	8.6
Adventa	ADV MK	152	RM	3.53	-	Not Rated	14.3	19.8	52.9	34.6	2.4	2.0	13.6	10.1
Other Consumer-related														
British American Tobacco	ROTH MK	3,519	RM	43.4	-	NEUTRAL	132.2	103.6	(1.5)	(0.8)	18.7	16.9	17.0	17.2
IOI Corporation	IOI MK	10,521	RM	5.45	-	REDUCE	18.0	17.5	13.0	15.4	3.3	3.1	21.0	18.2
Kuala Lumpur Kepong	KLK MK	5,247	RM	16.86	-	REDUCE	16.2	16.7	54.4	11.4	3.0	2.8	19.2	17.2
Industrials														
Gamuda	GAM MK	1,641	RM	2.78	-	BUY	9.2	12.7	50.0	46.7	1.7	1.6	18.5	12.6
IJM Corporation	IJM MK	1,724	RM	4.5	-	BUY	6.5	7.9	18.2	34.6	1.0	1.0	17.0	12.7
IGB Corporation	IGB MK	766	RM	1.8	-	BUY	6.3	6.4	9.1	8.3	0.9	0.8	15.0	13.8
WCT Berhad	WCT MK	606	RM	2.79	-	BUY	10.6	10.1	(5.3)	11.1	1.2	1.1	15.5	14.0
Telcos														
Axiata Berhad	AXIATA MK	9,249	RM	3.87	-	BUY	9.9	10.9	0.0	22.7	1.6	1.5	17.6	14.3
Digi.com	DIGI MK	5,141	RM	22.38	-	BUY	64.1	57.8	3.9	1.5	10.1	9.0	16.7	16.5
Financials														
Malayan Banking	MAY MK	14,484	RM	7.4	-	BUY	12.2	14.2	18.4	28.9	1.9	1.8	16.4	12.8
Bursa Malaysia	BURSA MK	1,126	RM	7.41	-	BUY	26.2	24.0	78.3	0.0	4.4	4.3	18.1	18.1
AMMB Holdings	AMMB MK	4,336	RM	4.8	-	BUY	11.2	13.5	14.3	37.5	1.5	1.4	15.0	10.9
Other Glovemakers														
Riverstone Holdings	RSTON SP	195	S$	0.63	-	Not Rated	19.8	20.0	33.0	28.0	2.4	2.0	12.2	9.5
Semperit AG	SEM AV	770	€	27.47	-	Not Rated	13.2	14.0	2.8	12.1	1.7	1.6	14.4	14.0
Sri Trang Agro* (via its 40:60 JV Siam Sempermed with Semperit AG)	STA TB	175	THB	28.75	-	U.R	8.9	8.5	(8.1)	2.2	0.6	0.5	6.6	6.5
Medical Devices														
Shandong Weigao	8199 HK	4,174.00	HK$	30.75	-	BUY	24.8	23.5	44.5	29.8	5.5	4.0	25.6	19.7

* Via its 40:60 JV Siam Sempermed with Semperit AG.

Source: Bloomberg (for not rated stocks), Nomura estimates

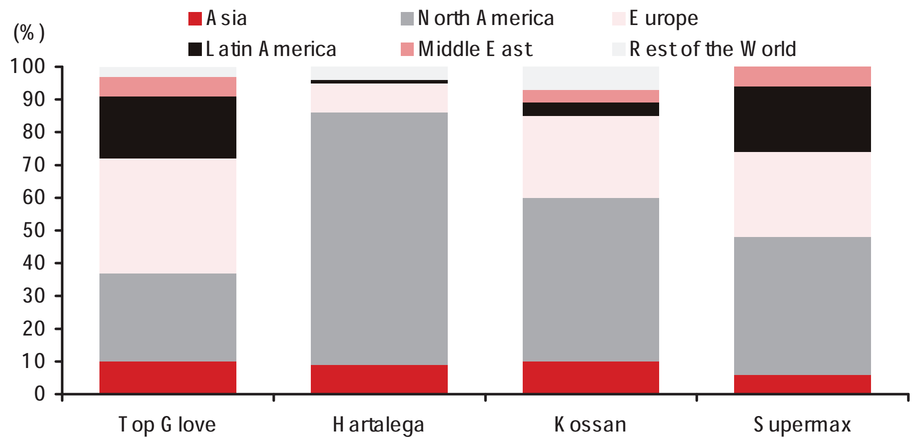
2010F industry prognosis: bright

A strong year ahead

We see demand staying strong in 2010F as glove producers see orders coming from new clients, including from non-medical segments, such as the military. Increasing health awareness and rising need for quality-proven and reliable products have prompted medical segment customers to consider switching to the more established players with reliable track records.

New demand seen from fresh sources

Exhibit 2. Stronger orders from most major markets



Source: Company data, Nomura research

Recent meetings with glove players have revealed that most still have backlogs of between three and five months in 2010, with some glove products being about seven months oversold. This comes on the back of existing customers increasing orders as fears of a second wave of influenza saw supply bottlenecks from 2H09 on. Price bidding was seen among a few customers, which partly contributed to the three-six price hikes averaging US$1 per box of thousand pieces per hike throughout the course of 2009.

Backlogs were compounded by the fact that glove players undertook minimal (and in some cases zero) capacity expansions in 2008. This left them largely unprepared for the huge uptick in demand, causing supply bottlenecks as the glove producers struggled to fill orders.

Minimal capacity expansion in 2008 and 2009 helped feed backlogs the industry is still struggling to fill

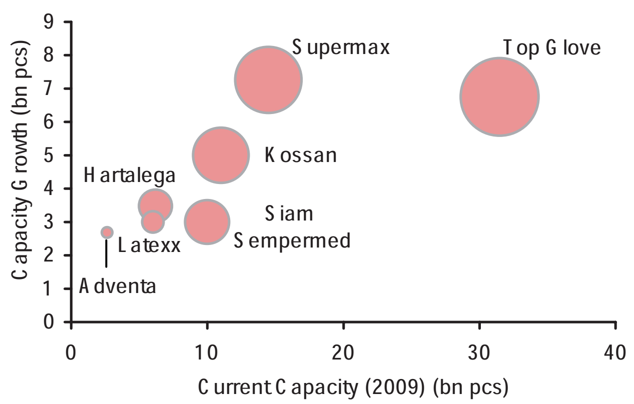
We should continue to see backlogged demand prop up strengthened supplier pricing power and cost pass-through: the supply-demand imbalance is still in favour of the glove players.

Exhibit 3. 52-week share price rally

(RM)	Ticker	Mar-09	Mar-10	% chg
Top Glove	TOPG MK	4.54	11.48	153
Supermax	SUCB MK	0.85	6.17	626
Kossan Rubber	KRI MK	3.00	7.24	141
Hartalega	HART MK	2.10	7.15	240
Adventa	ADV MK	0.9	3.4	278
Latexx	LTX MK	0.545	3.98	630
		Mar-09	Mar-10	% change
KLCI		866.93	1,286.1	48

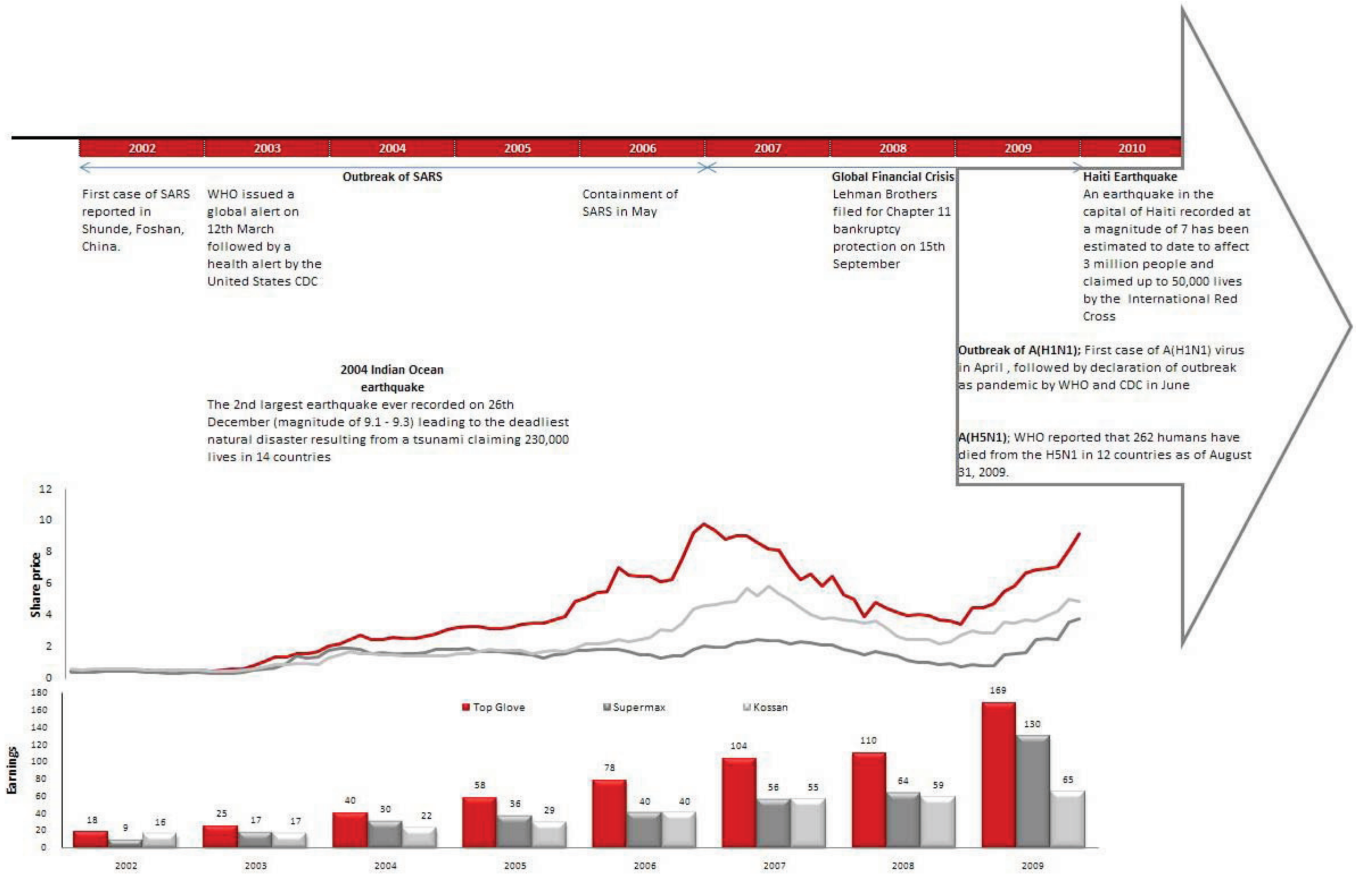
Source: Bloomberg as at 3 March

Exhibit 4. Snapshot of major players in the market



Source: Company data, Nomura estimates

Exhibit 5. Historical catalysts largely health-related



Source: Nomura, news reports, company data

Hence, we reiterate our positive demand prognosis for 2010F since existing production capacities are still running at all-time high utilisations of 80-90%. Average selling prices remain supported by high latex prices that hit 10-year highs of RM7.43/kg recently.

Utilization rates are at all-time highs

Catalysts for further re-rating

- **Strong quarterly earnings ahead; earnings upgrade potential exists —** Strong 4Q09 numbers were released by Kossan and Supermax recently, with both management teams remaining upbeat about prospects for the year. Top Glove, which is reporting its 2Q FY10F numbers next week, should see similar if not better results compared to its 1Q FY10 performance. We flag the possibility of earnings upgrades in the next few quarters if earnings continue to surprise on the upside as policy visibility on the issue of natural gas tariff hikes becomes clearer in the coming months.

- **Huge potential from large untapped markets — China and India.** Latent demand from China and India exists given a growing middle-income segment and increasing healthcare awareness. Currently, Malaysian 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 (see Healthcare Asia-Pacific Anchor Report — *Asia's vital signs*, 9 December, 2009). This has not been factored into our assumptions and increased demand from the region will be a positive upside for the Malaysian 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.

A potential wealth of untapped demand from China, India and Japan given healthcare reforms

Exhibit 6. India GDP forecast

% y-y growth unless otherwise stated	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	2009F	2010F	2011F
Real GDP (sa, % q-q, annualised)	**12.6**	**4.1**	9.9	9.6	11.4	5.9	8.4	9.4			
Real GDP	**7.9**	**6**	8.1	9	8.9	9.1	8.8	8.8	**6.4**	8.8	8.6
Private consumption	**5.5**	**3.4**	6.6	8	7	8.5	8	7.2	**3.9**	7.6	7.7
Government consumption	**26.9**	**(10.3)**	(2.0)	5.8	(10.2)	(5.1)	12.0	(6.8)	**4.9**	(3.0)	5.6
Fixed investment	**7.3**	**8.9**	14.9	14.2	16.5	13.5	11.1	15.1	**5.8**	14.8	13.5
Exports (goods & services)	**(17.1)**	**(4.8)**	7.9	13.6	18.6	15.6	14.9	16.9	**(9.4)**	13.8	15.5
Imports (goods & services)	**(10.5)**	**(9.7)**	6.0	18.1	20.3	20.7	22.5	18.6	**(8.5)**	16.4	19.2
M3 money supply	**19.8**	**18.2**	18.1	18.0	18.5	18.8	17.3	17.5	**19.5**	18.4	17.8
Non-food credit	**14.7**	**11.1**	14.8	15.2	17.3	19.7	21.1	22.6	**15.1**	16.8	22.6
Wholesale price index	**(0.1)**	**4.7**	9.5	9.5	8.6	7.4	5.9	6.2	**2.1**	8.7	6.2
Consumer price index	**11.8**	**13.3**	15.3	15.0	9.9	7.8	6.6	6.5	**10.9**	11.8	7.3
Merchandise trade balance (% GDP)	**(7.3)**	**(8.4)**	(6.5)	(6.8)	(6.4)	(8.5)	(5.0)	(6.7)	**(6.3)**	(7.1)	(6.6)
Current account balance (% GDP)									**(2.2)**	(1.9)	(1.5)
Fiscal balance (% GDP)									**(6.7)**	(6.0)	(4.8)
Repo rate (%)	**4.75**	**4.75**	4.75	5	5.25	5.75	6.25	6.5	**4.75**	5.75	7
Reverse repo rate (%)	**3.25**	**3.25**	3.25	3.5	3.75	4.25	4.75	5	**3.25**	4.25	5.5
Cash reserve ratio (%)	**5**	**5**	5.75	6.25	6.75	6.75	7	7	**5**	6.75	7.5
10-year bond yield (%)	**7.34**	**7.73**	8	8.5	8.5	8	7.75	7.6	**7.73**	8	7.5
Exchange rate (INR/US$)	**48**	**46.5**	46.2	45	43.7	42.3	40.5	40	**46.5**	42.3	39

Notes: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. CPI is for industrial workers. Fiscal deficit is for the central government and for fiscal year, eg, 2009 is for year ending March 2010. Table last revised on 5 March, 2010.

Source: CEIC and Nomura Global Economics.

Exhibit 7. China GDP forecast

% y-y growth unless otherwise stated	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	2009F	2010F	2011F
Real GDP	**9.1**	**10.7**	12	10.5	9.9	9.6	9.4	9.7	**8.7**	10.5	9.8
Consumer prices	**(1.2)**	**0.7**	1.9	2.9	3.3	3.0	3.3	3.2	**(0.7)**	2.8	3.5
Core CPI	**(1.5)**	**(0.6)**	0.5	0.8	1.2	1.6	2.0	2.4	**(1.1)**	1.0	2.0
Retail sales (nominal)	**15.4**	**16.5**	17.3	19.3	19.7	18.0	20.0	18.0	**15.5**	18.6	18.0
Fixed-asset investment (nominal, y-t-d)	**33.4**	**30.1**	36.0	38.0	32.0	30.0	26.0	24.0	**30.1**	30.0	25.0
Industrial production (real)	**12.3**	**18.0**	22.0	16.3	13.3	12.3	12.0	11.5	**11.0**	16.0	13.8
Exports (value)	**(20.3)**	**0.2**	15.5	15.2	7.8	7.5	4.1	8.6	**(16.0)**	11.0	8.3
Imports (value)	**(11.8)**	**22.6**	36.5	21.0	12.3	16.3	15.0	15.8	**(11.2)**	20.0	15.0
Trade surplus (US$bn)	**24.1**	**61.5**	33.3	26.3	29.5	51.8	7.6	7.4	**196.0**	141.0	73.0
Current account (% of GDP)									**5.8**	3.5	2.0
Fiscal balance (% of GDP)									**(2.2)**	(2.5)	(1.3)
1-yr bank lending rate (%)	**5.31**	**5.31**	5.58	5.85	6.12	6.12	6.39	6.66	**5.31**	6.12	7.2
1-yr bank deposit rate (%)	**2.25**	**2.25**	2.52	2.79	3.06	3.06	3.33	3.6	**2.25**	3.06	4.14
Reserve requirement ratio (%)	**15.5**	**15.5**	16.5	17	17.5	17.5	18	18	**15.5**	17.5	18
Exchange rate (RMB/US$)	**6.83**	**6.83**	6.82	6.68	6.55	6.45	6.4	6.35	**6.83**	6.45	6.1

Notes: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. All forecasts are modal forecasts (ie, the single most likely outcome). Table last revised 5 March, 2010.
Source: CEIC and Nomura Global Economics

- **Potential to grow US market —** It is still not the end of the road for US President Obama's top legislative priority — the overhaul of the nation's US$2.5tn healthcare system. Key similarities between the House and Senate versions regarding 2010 deliverables would be the proposed early investments into building community health centers.

  If undertaken, these appropriations will directly spur demand for medical consumables such as gloves, in our view. We see key beneficiaries being players like Supermax with its US distribution penetration and Kossan with its high US market exposure (50% of sales).

Exhibit 8. Early investments in community health centres could directly impact demand for medical disposables

Public Health / Workforce		
Mandatory appropriation	Total: US$34bn over 5 years Public health / wellness: US$16.9bn over 5 years Community Health Centers: US$12.0bn Workforce: US$5.0bn	Total: US$25bn over 5-10 years Public health / wellness: US$15bn over 10 years Community Health Centers: US$8.5bn over 5 years Workforce / National Health Service Corps: US$1.5bn over 5 years
	Numerous other authorisations	Numerous other authorisations

Source: US Tri-Committee House staff, US Congressional Budget Office, January, 2010

What could go wrong?

Too early to worry about industry glut

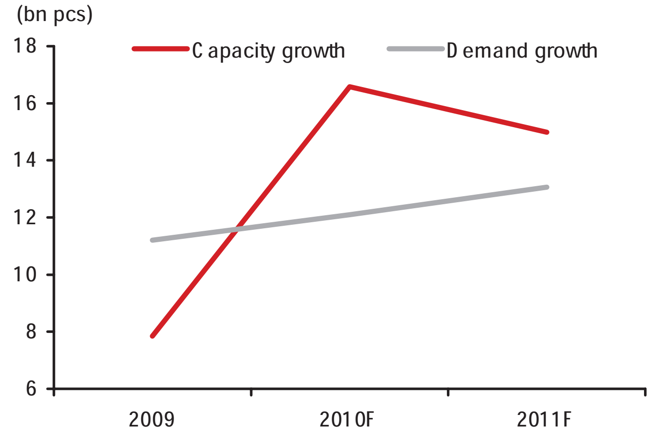
Current strong demand mitigates overcapacity risk

The existing players have a pretty good handle on supply

While our estimates below indicate the possibility of an industry glut, we argue that there is also a possibility of the glut not occurring, since most glove producers may revisit their proposed expansion plans should a hint of overcapacity threaten margins. This is because most have been through overcapacity situations, such as that in 2001. Planned expansions also may not come up as planned given potential restrictions in natural gas supply.

We draw reference to game theory and the prisoner's dilemma — in an environment of growing demand and sustained high ASPs, glove players may not cooperate to control production despite it being in their interest to do so. Given a higher perceived incentive to expand to grab market share at a higher rate than the growth of the market, overcapacity occurs as a result. *However*, should the same players be subject to the same adverse conditions multiple times, they may finally learn to adjust behaviours and corporate strategies accordingly.

Exhibit 9. Capacity expansions vs projected demand growth



Source: Company, Nomura estimates

Exhibit 10. Breakdown of capacity expansion plans for eight glove producers

(bn pcs)	FY09	FY10F	FY11F
Top Glove	1.5	3.8	3.0
Kossan	1.7	1.8	1.5
Supermax	0.0	3.1	4.2
Hartalega	2.9	1.2	2.2
Adventa	0.2	1.5	1.2
Latexx	1.6	1.6	1.4
Siam Sempermed		1.5	1.5
Riverstone		0.4	
Capacity Growth (bn pcs)	7.9	14.9	15.0
Est world market size	140.0	151.2	163.3
Est demand growth (bn pcs)	11.2	12.1	13.1

Source: Company, Nomura estimates

Announced capacity expansions are 15-23% higher than our projected world demand ...

While no official statistics exist on the exact size of the global glove market, news reports[1] and consensus put it a range of 130bn-150bn pieces in 2009E, with a growth rate pa over 8-12%. Based on our assumptions of a mid-range size of 140bn pieces and an 8% growth rate (lower end of expectations) in our projections, capacity expansion coming on-stream in 2010F and 2011F is 15-23% higher than projected additional world demand for gloves.

... which exceed the circa 20% overcapacity levels seen in 2001

This expected overcapacity is also higher than the 20% overcapacity faced by producers in 2001[2] given enthusiastic expansion in the 1990s. The low valuations seen currently are partly because of supply concerns, which we think are unwarranted since we believe demand assumptions have likely not factored in anticipated strong recoveries in the US and other economies.

[1] SME Corp Malaysia, 8 January, 2010

[2] June 18, 2001 - *Business Times*

We believe that the more established producers may be less susceptible given their long presence in the industry and having experienced the brunt of idle capacity situations. On our numbers, Top Glove, with the lowest estimated FY11F breakeven utilisation of 26%, is expected to be the least sensitive to any output declines.

However oversupply risk unlikely to emerge in 2010, owing to lines coming on-line gradually

Exhibit 11. Estimated breakeven utilisation rates in FY11F

Company	Estimated b/even utilisation (%)
Top Glove	26
Supermax	30
Kossan Rubber	35

Source: Nomura estimates

We conclude that in the face of strong demand for the next few quarters, in addition to the argument above regarding the possibility of capacity expansions not coming online as planned, it is too early to worry about the possibility of a glut in capacity.

We would revisit this stance should capacity expansion come up faster than planned or demand take an about turn, although we flag again that this would be an unlikely occurrence for the next few quarters.

Too early to worry about possible glut as demand is still strong and there is a possibility that capacity expansions may not come online as planned

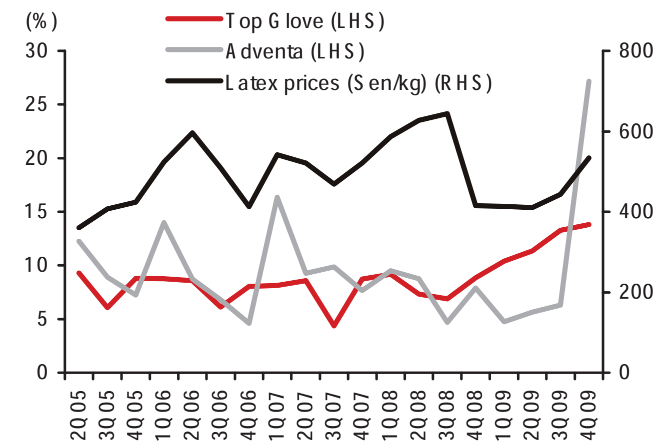
Consensus is pricing in a moderate cost increase

Given recent newsflow on potential electricity and natural gas tariff hikes being contemplated by the Malaysian Cabinet, the expected recovery of shipping rates and increased supplier power of shipping carriers as well as latex prices hovering at 10-year highs, we believe consensus and the market in general has priced in expectations of potentially tougher operating conditions.

We believe market has priced in expectations of a more difficult landscape

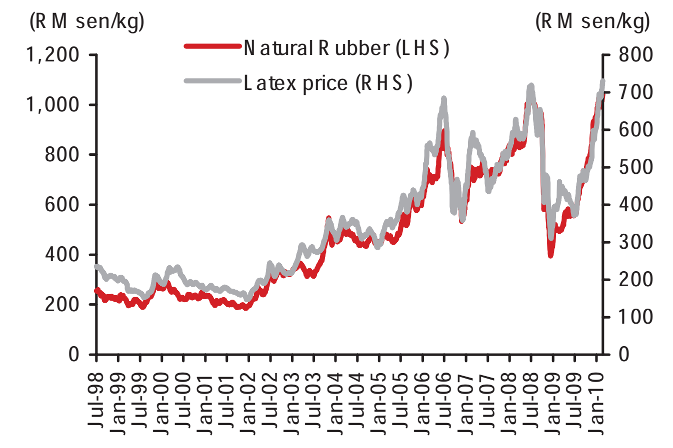
- Latex – Latex costs (encompassing natural and synthetic types) as a percentage of total costs can range from 50-55%, depending on prevailing latex prices. Fluctuating latex costs can lead to fluctuating margins as ASPs take one- or two-month lags to adjust, and smaller players experience a higher degree of fluctuation. We believe that the three to six ASP hikes in 2009 were more due to increased demand that bid prices up, rather than latex cost. Average latex costs in 2009 were RM4.51/kg, 21% lower than the 2008 average of RM5.68/kg.

Exhibit 12. Net margins higher despite lower average latex price in 2009



Source: Bloomberg, Company

Exhibit 13. High correlation between latex and natural rubber; latex at 10-year high



Source: Bloomberg

High latex costs currently serve as fresh impetus for glove players to hike ASPs again, supporting our view that margins will be sustained throughout 2010F. Most of the glove players' latex comes from Thailand (between 50-80%) and the remainder is sourced from Malaysian plantations. While latex sources are currently

High latex prices should sustain current ASPs

stable, we flag that Malaysia's natural rubber production has been on a decreasing trend over the years.

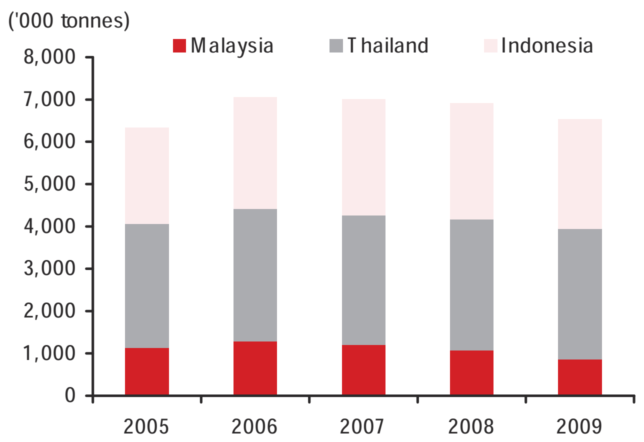
That implies a general downward supply trend for latex supplies from Malaysia, and should that persist, glove players will have to increase imports of latex from neighbouring countries. In this respect, Top Glove is the sole glove manufacturer we cover that owns two latex concentrate plants in Thailand to secure a constant flow of latex. We feel this protects it from supply risks mid-term.

Of the players covered here, Top Glove has the most dependable supply given its ownership of two latex concentrate plants

Fluctuating weather conditions, ie, unusual rainy season in late-2009 and drought reduced tapping activities in key rubber-producing regions. However, the latest data from the Association of Natural Rubber Producing Countries (ANRPC) show that Thailand's (the world's largest natural rubber producer) supply grew 23.8% on an annualised basis in January 2010, largely due to expansion of yielding area by 16,000ha and improving weather conditions going into 2010. Save Malaysia, the rest of the ANRPC members showed positive year-on-year January 2010 growth. ANRPC members account for some 94% of global natural rubber production.

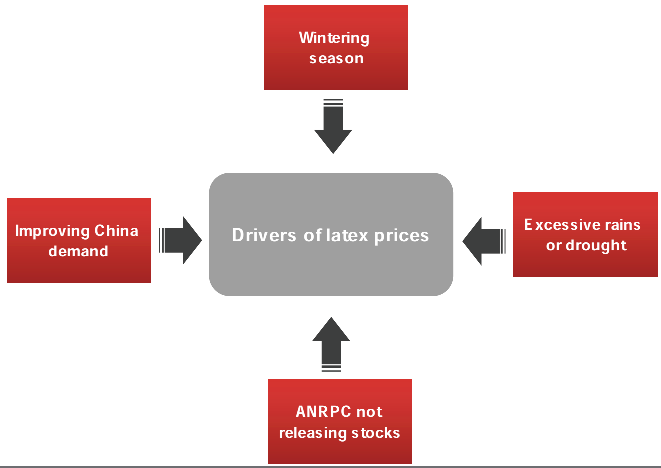
Latest data show positive growth in rubber supply in January 2010

Exhibit 14. M'sia NR production falling ('000 tonnes)



Source: ANRPC

Exhibit 15. Drivers of latex prices



Source: Nomura estimates

This leads us to conclude that the current high latex prices are driven more by other factors rather than supply limitations. Checks with glove players indicate no problems sourcing latex at the moment. Given this, we take a 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 improved demand for natural rubber following improvement in the outlook from China and India's auto industries (see China auto report dated 2 March, 2010, and India Auto & Auto Parts report dated 2 March, 2010). On a country basis, China consumes 26% of global natural rubber output and on an industry basis, the automotive sector consumes close to 60% of total natural rubber output.

High latex prices not fully justified by supply fundamentals, in our view

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

- Fuel — Malaysian glove manufacturers currently pay subsidised natural gas prices of RM15 per mmbtu, which is 20% off current market rates. We flag two risks in terms of natural gas supply: 1) shortage of gas supply, and; 2) impact on profitability should subsidies be removed.

Minimal benefit from recent reallocation of natural gas to manufacturing sector

  – Shortage of natural gas — About one-third of Malaysia's daily processed natural gas is allocated to the non-power sector, but that has not been sufficient to meet the growing needs of the manufacturing sector. The government, on 4 February, 2010, announced the reallocation of 100mmbtu per day from the power sector to the manufacturing sector. However, we do not think that this will directly benefit the glove players as the government intends to prioritise the oleochemical and food industries for the reallocation, and has announced that manufacturers need to look for alternative energy sources.

In that respect, glove manufacturers have installed biomass heaters in newer plants to overcome shortages. Despite higher fixed costs at the onset on the need for storage of biomass, Top Glove's management estimates that biomass provides energy cost savings of 15% and sufficient local supply of biomass materials ensures uninterrupted energy supply. Another case in point — Hartalega has been using biomass sources to power its Plant 1 and 2 since 2005, and as such its fuel cost is lower (8% versus a range of 9-11%) than the other players who only recently made forays into biomass-powered plants.

Players shifting towards biomass energy sources in their expansion, as an alternative to natural gas

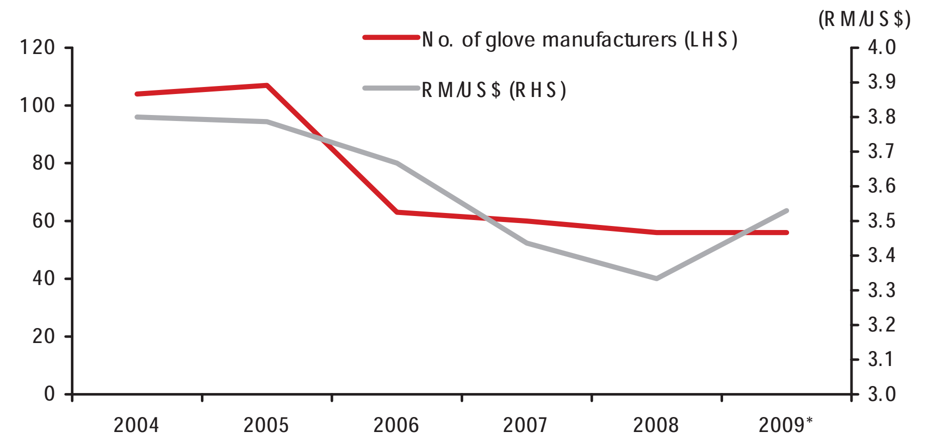
– Removal of gas subsidy — The issue of natural gas shortages, is a 'known known'. Whereas the removal of gas subsidies is more of a 'known unknown' — we know that current gas subsidies are unsustainable; Petronas paid out RM78bn in subsidies[3] over the past 10 years. The only question is when they will be addressed; policy visibility is unclear amid the recent government decision to abort its petrol subsidy restructuring scheme and the Prime Minister's pending announcement of the new economic model in end-March.

Tariff hikes likely given Malaysia's fiscal deficit is forecasted to hit 7.9% of GDP

The impact on the glove players will vary depending on their size and internal efficiencies — with the smaller players affected the most due to their weaker supplier power and lower economies of scale. Malaysian glove manufacturers currently pay RM15 per mmbtu, which is a 7% discount to the 3 March closing price of US$4.757 (RM16.2) for April delivery on the NYMEX and an estimated discount of 20% to the Malaysian market price[4]. The mitigant to this is the fact that fuel costs make up 9% of the glove manufacturers' costs on average (of which 60-80% comprises natural gas). (see EPS impact in "Company views")

- RM/US$ rate — Glove manufacturers quote ASPs in US dollars, and currently enjoy between 30% to 50% natural hedges owing to predominantly US$-denominated latex imported from Thailand. Most manufacturers sell a proportion of receivables forward to mitigate risk of exchange rate movement. It is estimated that should the exchange rate strengthen to RM3.15:US1, the top-line would fall by 1-2%. (details in "Company views" section)

Exhibit 16. De-pegging of ringgit in 2005 propelled industry consolidation



Source: Company, Nomura estimates

3 Economic Planning Unit presentation, 26 September, 2008

4 *The Star* - 25 February, 2010

Malaysia's comparative advantage

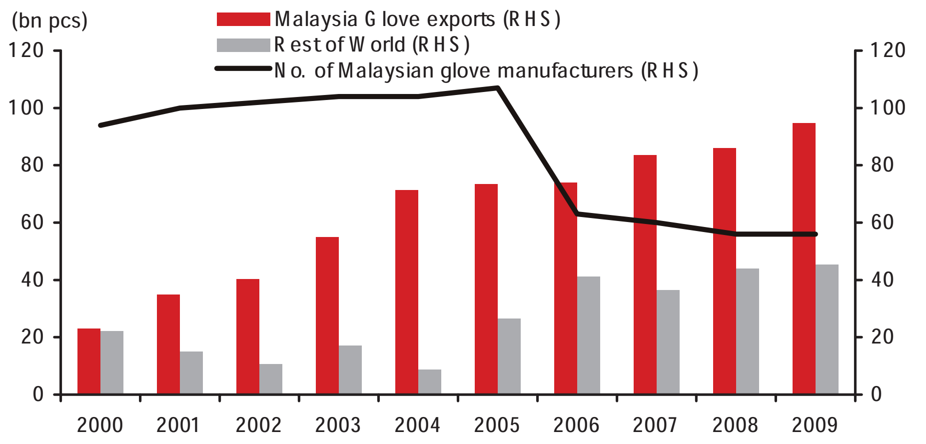
Malaysia — largest glove producer in the world

Malaysia's comparative advantage — luck or hard work?

We say 20% luck, 80% hard work. Over the past two decades, Malaysian glove producers have had to contend with fluctuating latex prices, exchange rate movements, overcapacity, negative consumer sentiment over latex allergy controversies and patent-related disputes.

The Malaysian glove sector is probably one of the rare few that deserves the recognition it gets

Exhibit 17. Malaysia vs rest of the world



Source: MARGMA, news reports, Nomura research

The main drivers that have ensured the success of the Malaysian glove-making industry are:

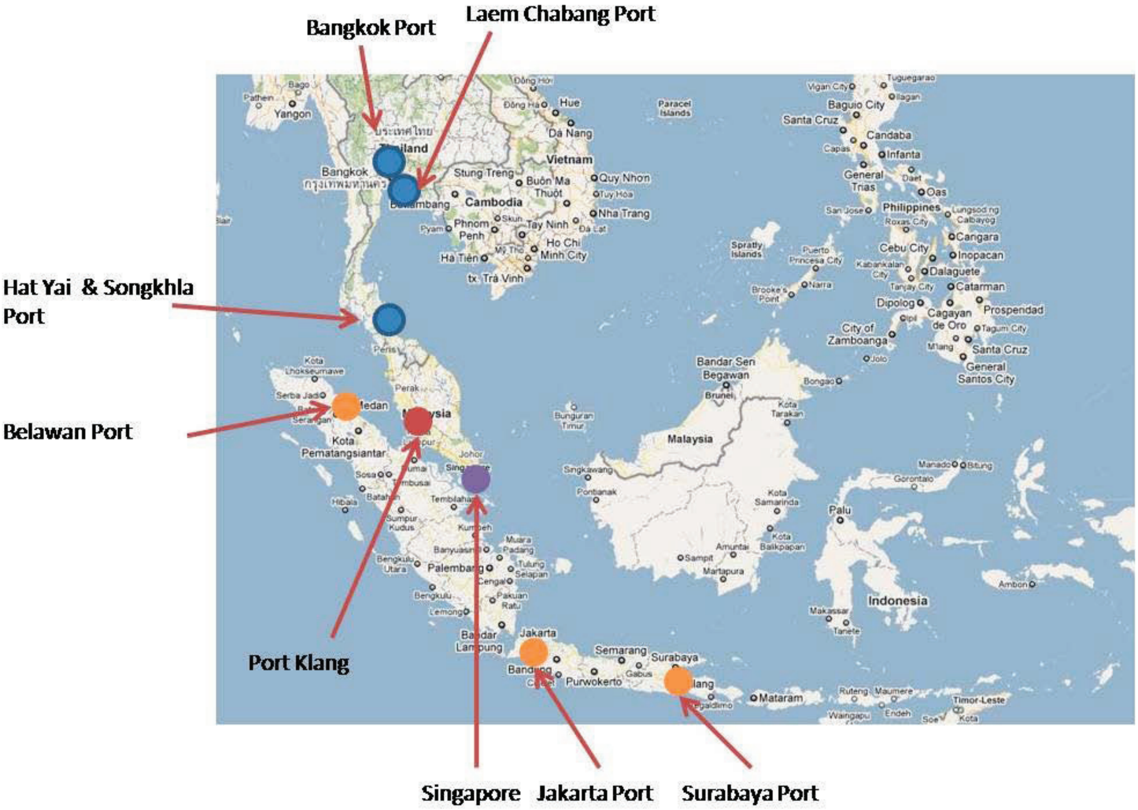
- Location, but also infrastructure — Proximity to raw material matters, hence the rationale for locating production facilities near latex sources. But while all three major rubber-producing nations boast of being close (or close enough) to sources of latex, Malaysia has better transport infrastructure than either Thailand or Indonesia, from its road networks right down to its international ports, namely Port Klang. In Thailand, as most of the rubber sources are located in the south, transportation costs are higher since the gloves need to be trucked to main ports like Bangkok or Laem Chabang before being shipped down to international hubs such as Singapore for onward transport to the ultimate destination.

  Similarly in Indonesia, since 70% of planted rubber area is in Sumatra and Kalimantan, shipments have to travel by land or by local waterways to reach the nearest main port before being sent to Singapore.

  Transport costs higher for manufacturers in Thailand and Indonesia

  The World Bank estimates that there are 300 ports in Indonesia, however, those cater mostly to local and small volumes, rendering bulk shipments virtually impossible. Port Klang's central location within Southeast Asia ensures its proximity to Singapore — the world's biggest port in terms of TEU.

Exhibit 18. Major ports in Southeast Asia



Source: Google Maps, World Bank data

- **Existence of supporting industries and organisations** — By nature, Malaysia is geographically blessed, however the supporting infrastructure evident today has been nurtured throughout the sector's 20-year development. Besides the government trade ministries, Malaysia counts four formal government and professional bodies — all dedicated to advancing, promoting and developing the rubber and rubber gloves industry.

Exhibit 19. Malaysia has the highest number of oversight authorities and professional organisations

	Malaysia	Thailand	Indonesia
Manufacturers' Association	Malaysian Rubber Glove Manufacturers Association	Thai Rubber Association	Rubber Association of Indonesia
Government bodies / Trade councils	Malaysian Rubber Board	(Being set up)	(general oversight by National Agency for Export Development)
	Malaysia Rubber Export Promotion Council	(general oversight by Department of Export Promotion)	
Research institutes	Rubber Research Institute of Malaysia	Rubber Research Institute of Thailand	(Under purview of the Indonesian Research Institute for Estate Crops)

Source: Thai Rubber Association, MARGMA, NAFED

First mover advantage hard to trump, in our view

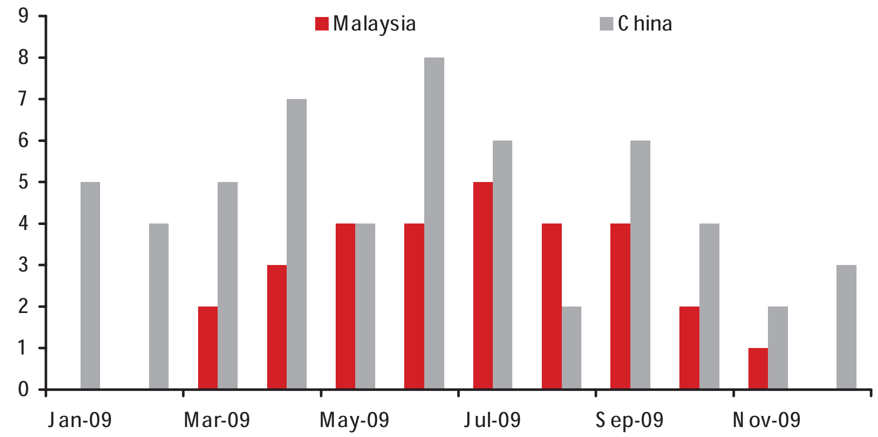
- **Stringent quality controls for gloves** — The US FDA, Brazil's ANVISA and the EU's CEN standards impose stringent specifications on gloves that are imported into their respective countries. Malaysia developed its Standard Malaysian Glove programme in consultation with the US FDA, ensuring local compliance on international levels. The main competitive advantage that Malaysian glovemakers have is that their gloves meet these specifications, and as such, already have a first mover advantage in medical glove markets. Continuously evolving requirements, like that of the December 2008 US FDA stringent revision of defect acceptance quality levels (ie, number of defects per batch), are addressed by glove manufacturers' in-house R&D teams. Testing is done on every batch of gloves pre-shipment.

Exhibit 20. Stringent requirements act as barriers to entry for new players

		New standard	
	Old standard	US	Brazil
Examination gloves	AQL 4	AQL 2.5	AQL 1.5
Surgical gloves	AQL 2.5	AQL 1.5	AQL 0.65
Others	-	-	Print distributor's name and glove lot/batch number of each glove

Source: U.S FDA, Company slides

Exhibit 21. Monthly FDA glove import refusal data by country



Source: US FDA

Compelling valuations enhance attractiveness

Malaysia glove valuations — a unique local story

This industry is a unique national play

Malaysia's market leadership in the glove sector backed by its proximity to raw materials and strength of supporting infrastructure, presents a unique national investment story to stand alongside the plantation, banking and construction investment themes currently.

Trading lower than the local market

Glove players are trading at 7.8-11.6x FY11F P/E levels underpinned by EPS CAGRs of 9-26% over the next three years. These valuations look attractive compared to market P/E of 14.5x and expected market earnings growth of 15% in 2010. (See individual company views for respective valuation arguments)

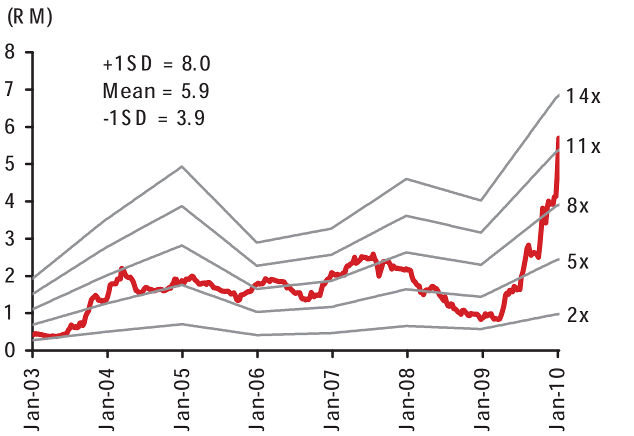
These P/E levels compare favourably to other Malaysia picks that are trading at P/Es of around mid-to-high teens. Our P/E-based price targets are also supported by DCF-based intrinsic values as highlighted in the respective company views.

Exhibit 22. Local and regional comparables

Companies	Ticker	Mkt cap (US$mn)	Curr.	Price (Loc)	Target price (Loc)	Rating	ROE (%) 2010F	ROE (%) 2011F	EPS gth (%) 2010F	EPS gth (%) 2011F	P/BV (x) 2010F	P/BV (x) 2011F	P/E (x) 2010F	P/E (x) 2011F
Malaysia Glovemakers														
Top Glove	TOPG MK	1,095	RM	11.98	15.16	BUY	27.3	29.1	45.6	26.4	3.7	3.1	14.7	11.6
Supermax	SUCB MK	497	RM	6.16	8.74	BUY	26.8	25.8	25.0	20.7	2.3	1.9	10.0	8.3
Kossan	KRI MK	350	RM	7.38	9.51	BUY	27.8	29.0	(5.5)	33.9	2.6	2.0	10.4	7.8
Hartalega	HART MK	522	RM	7.30	-	Not Rated	39.9	34.4	74.2	18.1	4.8	3.6	13.6	11.5
Latexx Partners	LTX MK	241	RM	4.03	-	Not Rated	46.5	40.4	94.7	27.0	n/a	n/a	10.9	8.6
Adventa	ADV MK	152	RM	3.53	-	Not Rated	14.3	19.8	52.9	34.6	2.4	2.0	13.6	10.1
Other Consumer-related														
British American Tobacco	ROTH MK	3,519	RM	43.4	-	NEUTRAL	132.2	103.6	(1.5)	(0.8)	18.7	16.9	17.0	17.2
IOI Corporation	IOI MK	10,521	RM	5.45	-	REDUCE	18.0	17.5	13.0	15.4	3.3	3.1	21.0	18.2
Kuala Lumpur Kepong	KLK MK	5,247	RM	16.86	-	REDUCE	16.2	16.7	54.4	11.4	3.0	2.8	19.2	17.2
Industrials														
Gamuda	GAM MK	1,641	RM	2.78	-	BUY	9.2	12.7	50.0	46.7	1.7	1.6	18.5	12.6
IJM Corporation	IJM MK	1,724	RM	4.5	-	BUY	6.5	7.9	18.2	34.6	1.0	1.0	17.0	12.7
IGB Corporation	IGB MK	766	RM	1.8	-	BUY	6.3	6.4	9.1	8.3	0.9	0.8	15.0	13.8
WCT Berhad	WCT MK	606	RM	2.79	-	BUY	10.6	10.1	(5.3)	11.1	1.2	1.1	15.5	14.0
Telcos														
Axiata Berhad	AXIATA MK	9,249	RM	3.87	-	BUY	9.9	10.9	0.0	22.7	1.6	1.5	17.6	14.3
Digi.com	DIGI MK	5,141	RM	22.38	-	BUY	64.1	57.8	3.9	1.5	10.1	9.0	16.7	16.5
Financials														
Malayan Banking	MAY MK	14,484	RM	7.4	-	BUY	12.2	14.2	18.4	28.9	1.9	1.8	16.4	12.8
Bursa Malaysia	BURSA MK	1,126	RM	7.41	-	BUY	26.2	24.0	78.3	0.0	4.4	4.3	18.1	18.1
AMMB Holdings	AMMB MK	4,336	RM	4.8	-	BUY	11.2	13.5	14.3	37.5	1.5	1.4	15.0	10.9
Other Glovemakers														
Riverstone Holdings	RSTON SP	195	S$	0.63	-	Not Rated	19.8	20.0	33.0	28.0	2.4	2.0	12.2	9.5
Semperit AG	SEM AV	770	€	27.47	-	Not Rated	13.2	14.0	2.8	12.1	1.7	1.6	14.4	14.0
Sri Trang Agro* (via its 40:60 JV Siam Sempermed with Semperit AG)	STA TB	175	THB	28.75	-	U.R	8.9	8.5	(8.1)	2.2	0.6	0.5	6.6	6.5
Medical Devices														
Shandong Weigao	8199 HK	4,174.00	HK$	30.75	-	BUY	24.8	23.5	44.5	29.8	5.5	4.0	25.6	19.7

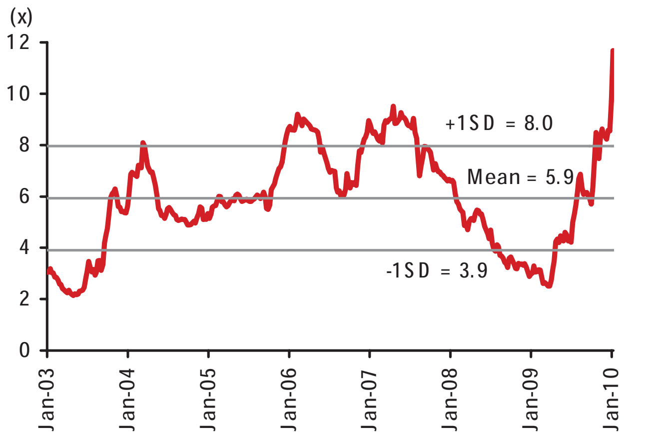
* Via its 40:60 JV Siam Sempermed with Semperit AG
Source: Bloomberg (for not rated stocks), Nomura estimates

Exhibit 23. Supermax — historical P/E band



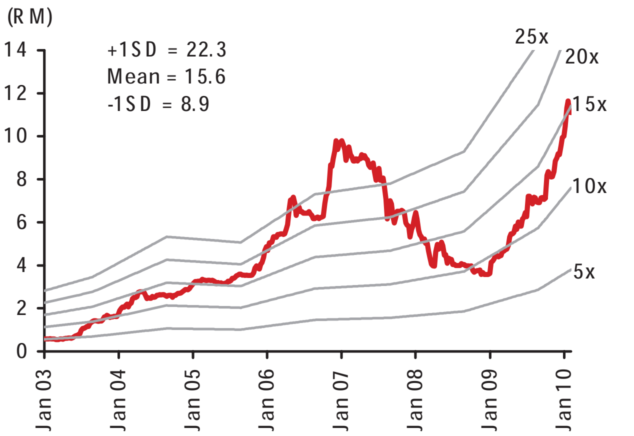
Source: Bloomberg, Nomura

Exhibit 24. Supermax — historical P/E chart



Source: Bloomberg, Nomura

Exhibit 25. Top Glove — historical P/E band

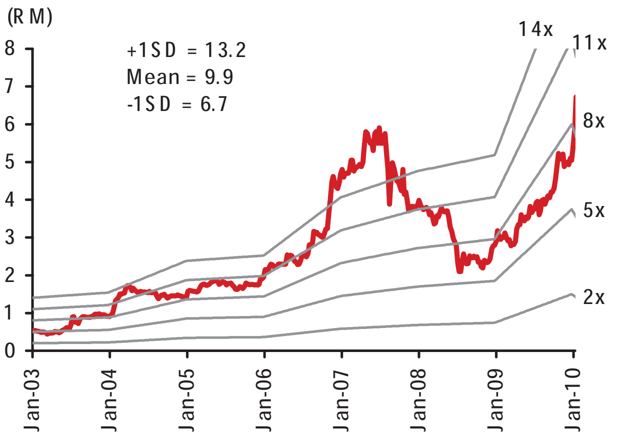


Source: Bloomberg, Nomura

Exhibit 26. Top Glove — historical P/E chart

Source: Bloomberg, Nomura

Exhibit 27. Kossan — historical P/E band



Source: Bloomberg, Nomura

Exhibit 28. Kossan — historical P/E chart

Source: Bloomberg, Nomura

Supermax Corporation Berhad

SUCB MK

HEALTHCARE & PHARMACEUTICALS | MALAYSIA

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Initiating

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NOMURA SECURITIES MALAYSIA SDN BHD

BUY

Action

We initiate on Supermax with a BUY rating with 42% upside driven by increased contributions from its higher-margin distribution arms and improved operational metrics after the write-off of its APLI investment at end-FY08. Current valuations of 8.3x PER for FY11F and a 3-year EPS CAGR of 17% remain compelling.

Catalysts

Catalysts for this stock are better-than-expected growth from its distribution arms and positive demand uptake from US healthcare reforms.

Anchor themes

With no imminent risks in the near term, the glove sector looks set to benefit from another year of strong growth. Companies with exposure to faster-growing markets, a diversified revenue base and efficient cost structures remain our top picks.

Closing price on 5 Mar	RM6.16
Price target	**RM8.74**
Upside/downside	42.0%
Difference from consensus	5.0%
FY11F net profit (RMmn)	204.0
Difference from consensus	14.9%

Source: Nomura

Nomura vs consensus

Consensus EPS estimate range is wide, at RM0.48 to RM0.78. Our FY11F EPS is largely in the mid-range of consensus estimates

The turnaround story

① The panther* likely to run harder this year

After 41% growth in earnings in FY09, we expect Supermax to post 25% growth in earnings to RM0.62 / share in FY10F and further 20.7% growth in FY11F. This is despite having undertaken virtually zero capacity expansions between 2008 and 2009. EPS growth will continue to be supported by strong income from distribution arms, which surprised on the upside in FY09, given the 122% increase from FY08. Management's recent announcement on 3 March of a 1-for-4 bonus issue implies potential for better stock tradeability.

* The panther is Supermax's corporate logo

② Operational efficiencies remain a focus

Improved operational metrics like inventory and receivables levels after the APLI write-off have seen an improvement in gearing, from 0.9x to 0.3x. The early redemption of its bonds has freed it from restrictive operational covenants and allows it more operational flexibility moving forward, which should drive growth of the business.

③ Initiate with BUY rating at price target of RM8.74

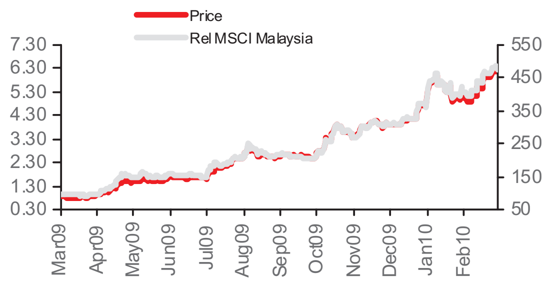
At 8.3x FY11F PE currently, Supermax's valuation is + 1SD from its historical mean. However, we argue the stock deserves a re-rating upwards given its clearer and stable earnings visibility and improved operational metrics following the APLI investment write-off. Even at these levels, the stock still looks attractive versus industry peers. Our PE-based valuation is also supported by a DCF intrinsic value of RM9.01.

Key financials & valuations

31 Dec (RMmn)	FY09	FY10F	FY11F	FY12F
Revenue	815	1,061	1,172	1,373
Reported net profit	129.8	168.9	204.0	215.5
Normalised net profit	135.1	168.9	204.0	215.5
Normalised EPS (RM)	0.49	0.62	0.75	0.79
Norm. EPS growth (%)	41.1	25.0	20.7	5.6
Norm. P/E (x)	12.5	10.0	8.3	7.8
EV/EBITDA (x)	9.0	7.3	5.9	5.3
Price/book (x)	3.0	2.3	1.9	1.6
Dividend yield (%)	1.6	2.0	2.5	2.6
ROE (%)	26.5	26.8	25.8	22.4
Net debt/equity (%)	31.5	18.1	8.1	0.6
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (RM)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI Malaysia



	1m	3m	6m
Absolute (RM)	22.7	55.9	136.9
Absolute (US$)	25.6	56.7	148.3
Relative to Index	19.4	54.8	135.0
Market cap (US$mn)			496.6
Estimated free float (%)			58.0
52-week range (RM)			6.17/0.84
3-mth avg daily turnover (US$mn)			5.40
Stock borrowability			Hard
Major shareholders (%)			
Dato Seri Stanley Thai			20.7
Datin Seri Cheryl Tan			15.3

Source: Company, Nomura estimates

Drilling down

The panther likely to run harder this year

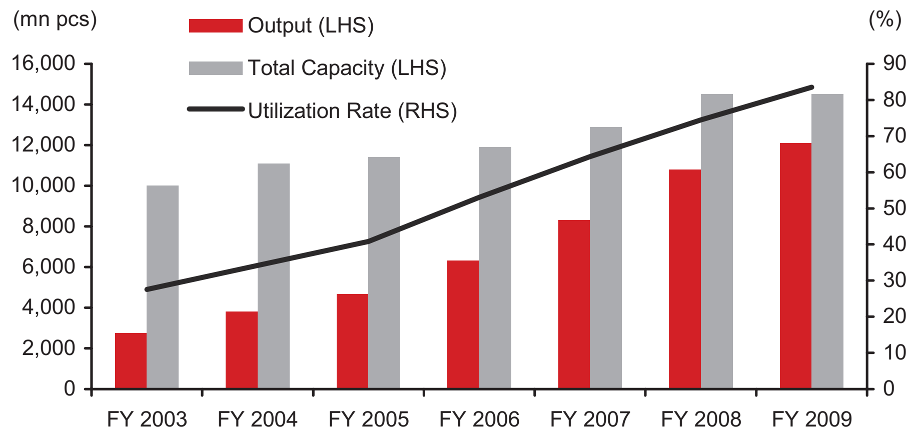
The 2005 APLI investment severely hampered Supermax's growth and corporate strategy

The street had high hopes for Supermax in FY09, given increased market demand and Supermax's full write-off in FY08 of its 2005 investment in APL Industries Berhad (APLI). The investment in APLI had prompted a one-off loss of RM17mn in FY08 and RM11mn in acquisition costs and equity injections over the years. The investment in APLI created a drag on working capital management in addition to financial resources and time. Moving forward however, with the APLI investment off the company's books, Supermax is likely to see improved working capital ratios.

Output growth was 12% in FY09, compared to FY08's 30%, largely due to the write-off of 2.6bn pcs of capacity from the APLI investment compounded by zero capacity expansions.

Announced FY09 revenue of RM815mn was 13% lower than the consensus estimate of RM921mn, due in part to a drop in the turnover contribution from APLI of circa RM40mn. FY09 was characterized by severe constraints on Supermax's production capacity, having made the lowest capacity expansions versus its peers throughout FY05-09 owing to the fact that management resources were tied up in trying to turn APLI around. Hence, we expect the top-line to rebound in FY10F as Supermax's expansion comes on-stream and higher ASPs are seen.

Exhibit 43. Utilisation rates and output on the uptrend

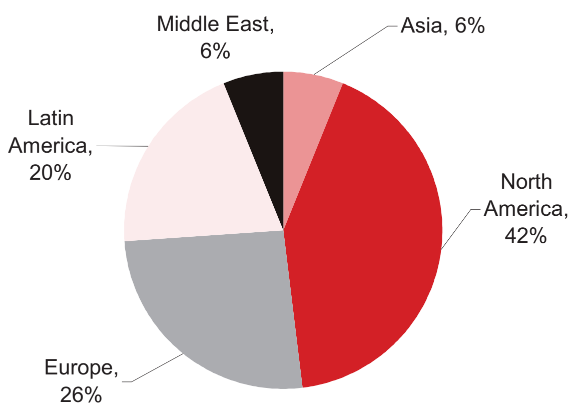


Source: Company data

Expansion plans brought forward in 2009 due to backlogged demand

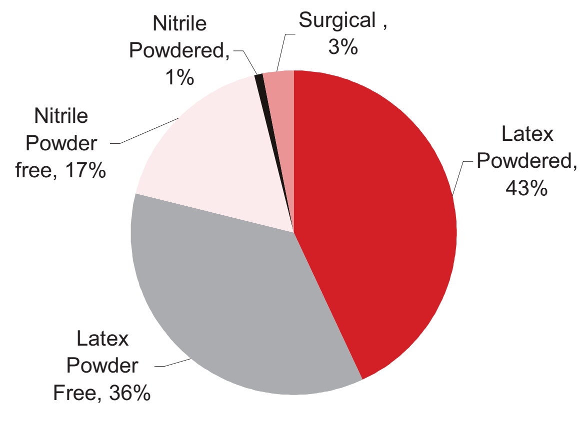
With 3.1bn pcs of capacity coming online throughout 2010, Supermax is well-placed to capitalise on the rosy demand outlook for the year. In late 2009, management decided to bring forward its capacity expansion plans at its Lot 6069, of which 6 lines are due to be commissioned in March / April 2010. The remaining two batches will come online in June 2010 (6 lines) and July / August 2010 (4 lines). Management also has plans for its 37-acre landbank in Mukim Kapar Klang, where it will build Phase 1 of its Glove City project housing 32 new production lines with capacity of 4.15bn pcs, targeted to be commissioned in 2011.

Exhibit 44. FY09 sales mix by destination



Source: Company data

Exhibit 45. FY09 product mix



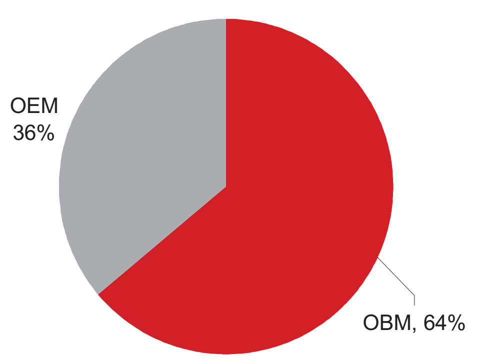
Source: Company data

Management targets a gearing ratio of 0.5 to 0.75

Despite flat sales growth, Supermax's earnings were boosted by a 122% increase in contribution from its distribution arms (wholly-owned and associates), bringing overall net margins from historical single-digit levels to double-digit levels (15.9% in FY09, from 9.3% in FY08). 43.4% of FY09 income was contributed by the distribution arm, versus 31.3% in FY08. While we expect overall margin levels to stay robust at around 16%, given increased output, our growth assumptions for its distribution income in FY10F are pegged at a conservative level of 20%, underpinned by expectations of a weaker US$ and a stronger MYR as well as management's unhedged currency exposure (as we discuss later).

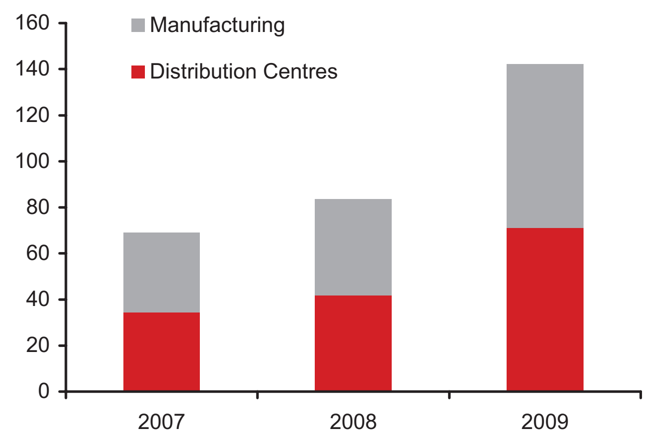
This focus on growing its OBM segment is a differentiating factor in strategy between Supermax and the rest of the companies we cover. Other players like Top Glove and Kossan pursue an OEM strategy, teaming up with local distributors in the countries they export to. For example, Brazil is one of Supermax's growing export markets in Latin America, similar to Top Glove. However, Top Glove teams up with local distributors whereas Supermax distributes its gloves via its 50%-owned distribution centre Supermax Brasil.

Exhibit 46. OBM versus OEM mix



Source: Company data (as at February 2010)

Exhibit 47. Distribution income increasing (RMmn)



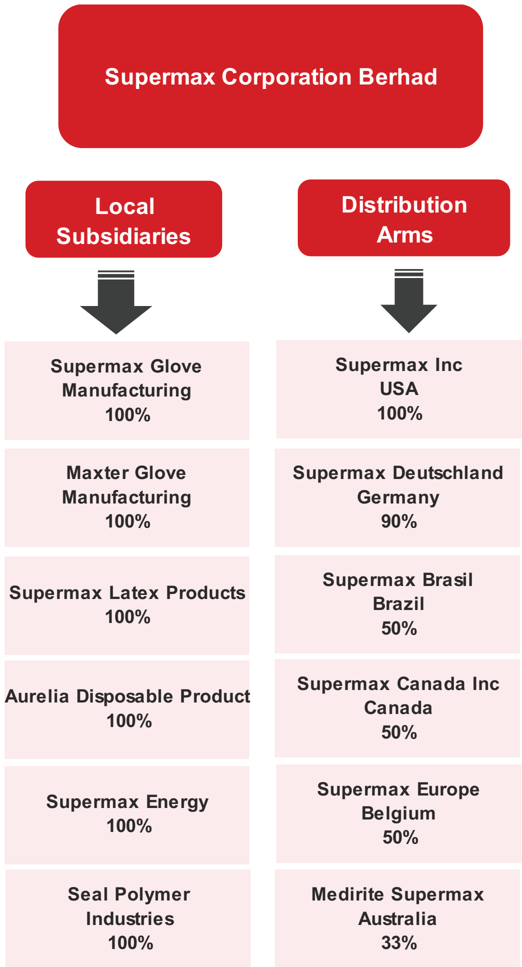
Source: Company data

Distribution income gave Supermax a margin lift in FY09

In line with its commitment to focus on beefing up its distribution strength and OBM strategy, management recently set up another distribution centre to tap into the Eastern European bloc, Supermax Germany, bringing its total worldwide distribution centres to six. Setup costs were estimated in the region of €100-200k. Management estimates that it will contribute an additional RM1-RM2mn to the bottom line for FY10F, given that the existing client base was previously customers of APLI's.

Management aims to achieve a 50:50 proportion of distribution and manufacturing income, versus the current 45:55 ratio currently.

Exhibit 48. Supermax's corporate structure



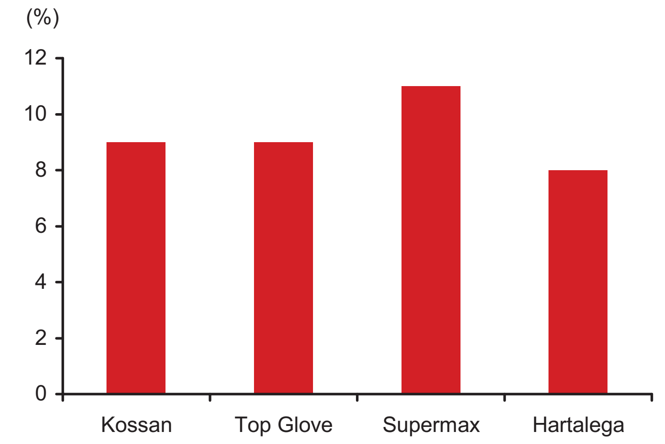
Source: Company data

Operational efficiencies remain a focus

The group also fully redeemed the remaining RM90mn on its RM120mn bond due in 2012. In line with the redemption, a one-off charge was made to expense the remaining portion of the upfront fee of RM5.37mn which would otherwise have been amortized over the bond tenure. Expected cost savings were RM2.4mn, but the purpose of the exercise was mainly to free the Group from the bond's operationally restrictive covenants. Net gearing fell from 0.9x in FY08 to 0.31x in FY09 due to a lower cash conversion cycle.

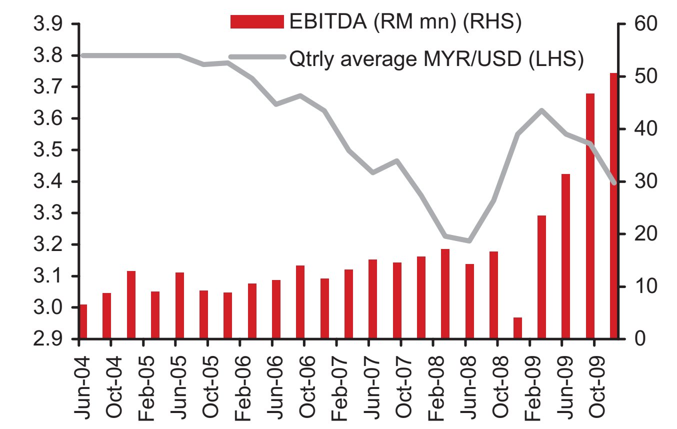
Output (measured by number of pcs shipped) fell 5.2% q-o-q in 4Q09 because the uptick in container demand that quarter caused a few customers to face a delay in procuring container space for their shipments. Management, in anticipation of a recovery in container rates, had previously re-negotiated some of its pricing arrangements from FOB to CIF delivery terms and did not face any increased shipment costs in that quarter.

Exhibit 49. Highest fuel cost among competitors



Source: Company data (for 2009)

Exhibit 50. Stable and growing EBITDA



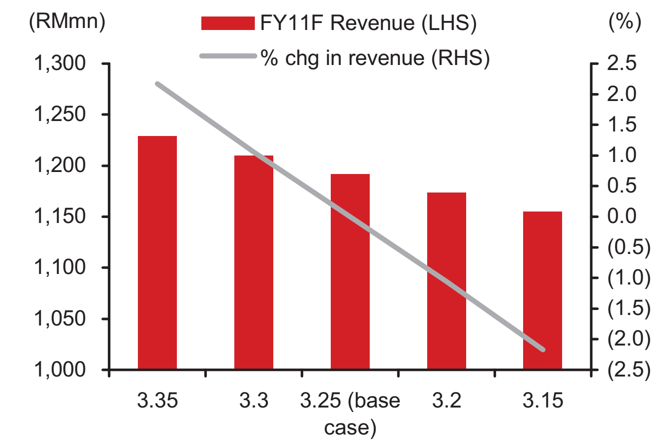
* 4Q08 includes RM17mn APLI write-off

Source: Nomura, company, Bloomberg

EBITDA largely remained stable over FY05-08 despite management having to grapple with operational setbacks at APLI.

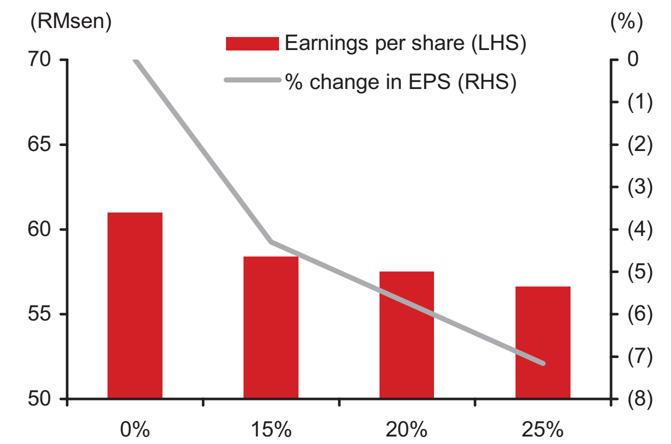
As far as we could gather, management does not hedge in any form. Hence an appreciation of the Malaysian ringgit to RM3.15 / USD would knock 2.2% off FY11F revenue, on our estimates. Our assumptions include a 30% natural hedge from latex costs. We also flag that the increased contribution from associates was also due to the appreciation of those currencies against the USD in FY09.

Exhibit 51. Revenue sensitivity to MYR/USD changes



Source: Nomura estimates

Exhibit 52. FY10F EPS impact from natural gas hike



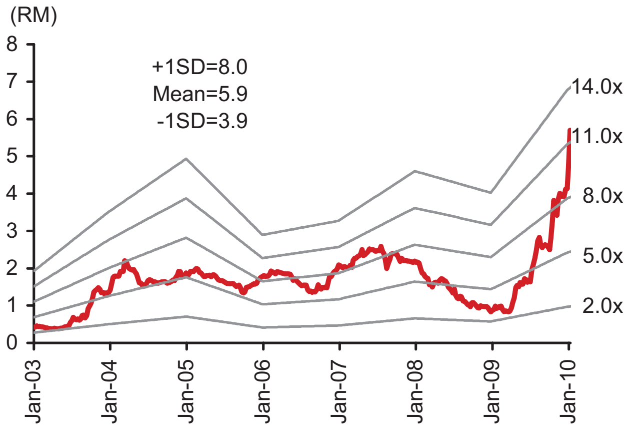
Source: Nomura estimates

Given expectations of a natural gas rate hike, we ran a sensitivity assuming an immediate hike to market prices of about RM18 / mmbtu (which is 20% above the current rate of RM15 / mmbtu). We assume 80% of its fuel cost constitutes natural gas and that 100% of the rate hike cannot be passed through. Based on our estimates, FY10F EPS would be reduced by 5.7% should an immediate gas hike occur.

Initiate with a BUY rating at price target of RM8.74

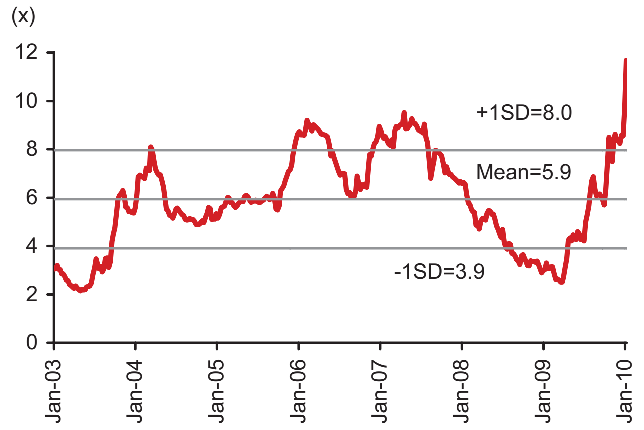
Supermax is currently trading at what looks an attractive 8.3x FY11F PE, which implies a 43% discount to the market's one-year forward PE of 14.5x. Given expected EPS growth of 25% and 20.7% for FY10F and FY11F, respectively, we peg FY11F earnings to a target PE of 11.5x, which is still 21% below Top Glove's. This 21% was derived from its historical discount of circa 30% to Top Glove, however we argue that it should see an upward re-rating given its write-off of the APLI investment, which will no longer be a drag on operational performance.

Exhibit 53. Historical PE band chart



Source: Bloomberg, Nomura

Exhibit 54. Historical PE chart



Source: Bloomberg, Nomura

Our assumptions incorporate a discount of 50% for new capacity coming online throughout the year, as well as price assumptions in the low to mid-range of those guided by management. We expect overall utilisation rates to fall from current levels in FY10F given additional capacity coming online in FY10F and FY11F before rebounding in FY12F.

Exhibit 55. Key assumptions and figures

		2010F	2011F	2012F
Inflation rate (%)		4.50	5.20	5.20
RM/US$		3.30	3.25	3.25
Capex per year (RMmn)		42.5	57.5	30
Utilization rate (%)		74	70	75
Depreciation rate (%)		6	6	6
Glove ASPs (US$ per '000 pieces)				
- Latex powdered		23.8	22.5	22.3
- Latex powder free		26.0	25.5	25.3
- Nitrile powdered		29.0	28.0	27.5
- Nitrile powder free		32.0	31.0	30.5
- Surgical		60.0	60.0	60.0
Average latex (RMsen/kg)		665	630	590
Beta	1.032			
Risk free rate (%)	3.75%			
Risk premium (%)	4.50%			
Terminal growth rate (%)	2%			
Discount rate (%)	7.15%			
DCF / share (RM)	9.01			

Source: Nomura

Exhibit 56. Intrinsic Value Sensitivity Analysis

Intrinsic value sensitivity analysis						
		WACC				
	9.01	7.0%	7.5%	8.0%	8.5%	9.0%
Perpetual growth rate	1%	8.27	7.62	7.06	6.58	6.16
	2%	9.28	8.42	7.72	7.12	6.61
	3%	10.79	9.59	8.64	7.86	7.21
	4%	13.30	11.42	10.02	8.92	8.05
	5%	18.34	14.72	12.31	10.60	9.31

Source: Nomura estimates

Downside risks include adverse and rapid currency movements. Upside risks to our target price include positive developments in US healthcare reform, given that Supermax has a major presence in North America.

Financial statements

Income statement (RMmn)					
Year-end 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Revenue	812	815	1,061	1,172	1,373
Cost of goods sold	(604)	(572)	(785)	(855)	(1,049)
Gross profit	**208**	**243**	**277**	**317**	**324**
SG&A	(109)	(110)	(114)	(120)	(126)
Employee share expense	-	-	-	-	-
Operating profit	**99**	**132**	**162**	**197**	**198**
EBITDA	**128**	**164**	**196**	**234**	**236**
Depreciation	(29)	(31)	(34)	(37)	(38)
Amortisation	-	-	-	-	-
EBIT	**99**	**132**	**162**	**197**	**198**
Net interest expense	(20)	(17)	(13)	(12)	(12)
Associates & JCEs	19	42	50	60	78
Other income	-	-	-	-	-
Earnings before tax	**97**	**158**	**200**	**246**	**265**
Income tax	(5)	(22)	(31)	(42)	(49)
Net profit after tax	**92**	**135**	**169**	**204**	**215**
Minority interests	-	-	-	-	-
Other items	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Normalised NPAT	**92**	**135**	**169**	**204**	**215**
Extraordinary items	(17)	(5)	-	-	-
Reported NPAT	**76**	**130**	**169**	**204**	**215**
Dividends	(9)	(26)	(34)	(41)	(43)
Transfer to reserves	**67**	**104**	**135**	**163**	**172**
Valuation and ratio analysis					
FD normalised P/E (x)	18.0	12.5	10.0	8.3	7.8
FD normalised P/E at price target (x)	25.6	17.7	14.1	11.7	11.1
Reported P/E (x)	21.4	13.0	10.0	8.3	7.8
Dividend yield (%)	0.5	1.6	2.0	2.5	2.6
Price/cashflow (x)	30.6	7.1	17.3	10.6	11.4
Price/book (x)	3.9	3.0	2.3	1.9	1.6
EV/EBITDA (x)	14.0	9.0	7.3	5.9	5.3
EV/EBIT (x)	17.4	10.6	8.5	6.8	6.1
Gross margin (%)	25.6	29.8	26.1	27.1	23.6
EBITDA margin (%)	15.7	20.1	18.5	20.0	17.2
EBIT margin (%)	12.2	16.3	15.3	16.8	14.4
Net margin (%)	9.3	15.9	15.9	17.4	15.7
Effective tax rate (%)	5.1	14.2	15.4	16.9	18.6
Dividend payout (%)	11.4	20.0	20.0	20.0	20.0
Capex to sales (%)	4.7	2.8	4.0	4.9	2.2
Capex to depreciation (x)	1.3	0.7	1.3	1.6	0.8
ROE (%)	18.8	26.5	26.8	25.8	22.4
ROA (pretax %)	13.4	20.1	23.3	24.0	22.8
Growth (%)					
Revenue	41.4	0.4	30.2	10.5	17.1
EBITDA	34.6	28.2	19.7	19.5	1.0
EBIT	32.0	34.0	22.6	21.6	0.4
Normalised EPS	6.6	41.1	25.0	20.7	5.6
Normalised FDEPS	21.9	44.6	25.0	20.7	5.6
Per share					
Reported EPS (RM)	0.29	0.47	0.62	0.75	0.79
Norm EPS (RM)	0.35	0.49	0.62	0.75	0.79
Fully diluted norm EPS (RM)	0.34	0.49	0.62	0.75	0.79
Book value per share (RM)	1.58	2.08	2.63	3.26	3.91
DPS (RM)	0.03	0.10	0.13	0.15	0.16

Source: Nomura estimates

Low tax rate due to reinvestment and investment tax allowances

Cashflow (RMmn)					
Year-end 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
EBITDA	128	164	196	234	236
Change in working capital	(38)	91	(38)	(31)	(39)
Other operating cashflow	(37)	(19)	(60)	(43)	(51)
Cashflow from operations	**53**	**236**	**97**	**159**	**147**
Capital expenditure	(39)	(23)	(43)	(58)	(30)
Free cashflow	**15**	**213**	**55**	**102**	**117**
Reduction in investments	(20)	(39)	(50)	(60)	(78)
Net acquisitions	(19)	-	-	-	-
Reduction in other LT assets	5	(0)	(1)	(1)	(1)
Addition in other LT liabilities	(7)	1	-	-	-
Adjustments	23	39	52	63	81
Cashflow after investing acts	**(4)**	**213**	**56**	**103**	**118**
Cash dividends	(9)	(19)	(26)	(34)	(41)
Equity issue	0	4	-	-	-
Debt issue	35	-	-	-	-
Convertible debt issue	-	-	-	-	-
Others	(20)	(110)	(13)	(13)	(13)
Cashflow from financial acts	**6**	**(125)**	**(39)**	**(46)**	**(54)**
Net cashflow	**2**	**88**	**16**	**57**	**65**
Beginning cash	29	31	119	135	192
Ending cash	31	119	135	192	257
Ending net debt	375	176	128	71	6

Source: Nomura estimates

Balance sheet (RMmn)					
As at 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Cash & equivalents	31	119	135	192	257
Marketable securities	-	-	-	-	-
Accounts receivable	241	140	218	241	282
Inventories	136	106	161	187	220
Other current assets	-	-	-	-	-
Total current assets	**407**	**365**	**514**	**620**	**759**
LT investments	116	155	205	265	344
Fixed assets	383	374	384	405	396
Goodwill	29	29	29	29	29
Other intangible assets	-	-	-	-	-
Other LT assets	11	11	12	13	15
Total assets	**947**	**934**	**1,144**	**1,333**	**1,543**
Short-term debt	231	129	129	129	129
Accounts payable	109	61	164	182	217
Other current liabilities	4	12	4	4	4
Total current liabilities	**343**	**202**	**296**	**314**	**350**
Long-term debt	175	165	134	134	134
Convertible debt	-	-	-	-	-
Other LT liabilities	8	9	9	9	9
Total liabilities	**526**	**376**	**439**	**457**	**493**
Minority interest	-	-	-	-	-
Preferred stock	-	-	-	-	-
Common stock	133	134	134	134	134
Retained earnings	203	317	460	630	805
Proposed dividends	4	-	4	4	4
Other equity and reserves	81	107	107	107	107
Total shareholders' equity	**420**	**558**	**705**	**875**	**1,050**
Total equity & liabilities	**947**	**934**	**1,144**	**1,333**	**1,543**
Liquidity (x)					
Current ratio	1.19	1.80	1.74	1.97	2.17
Interest cover	4.9	7.9	12.6	16.4	17.2
Leverage					
Net debt/EBITDA (x)	2.94	1.07	0.65	0.30	0.03
Net debt/equity (%)	89.1	31.5	18.1	8.1	0.6
Activity (days)					
Days receivable	103.6	85.2	61.5	71.4	69.7
Days inventory	73.3	77.0	62.0	74.3	71.1
Days payable	62.8	54.2	52.3	73.9	69.7
Cash cycle	114.1	108.0	71.2	71.8	71.0

Source: Nomura estimates