

Rubber Gloves

OVERWEIGHT

Maintained

Time to put your gloves back on

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- Maintain OVERWEIGHT.** We left the recent 5th International Rubber Glove Conference & Exhibition (IRCGE) feeling positive about the sector. Despite considerable headwinds encountered by the sector this year, demand for rubber gloves continues to grow at a healthy clip. With continued technological advancement of glove products and facilities, we believe Malaysian rubber glove manufacturers will maintain its leadership in the global market. In light of the positive long term prospects of the industry, we maintain our OVERWEIGHT call. All the glove stocks under our coverage remain as Outperforms. Potential re-rating catalysts include the continuing uptick in demand from the healthcare industry, ongoing capacity expansion and strong earnings growth. The recent sharp pullback in share prices has made the sector even more attractive with undemanding average P/Es of 7-8x. Supermax and Latexx remain our top picks.
- Malaysia still dominates.** In 2009, a total of 69.8bn pairs or 139.6bn pieces of gloves were exported globally. This is 10.8% higher than 2008's figure of 63bn pairs or 126bn pieces. MREPC highlighted that Malaysia continues to dominate the world rubber gloves market by capturing about 60.8% of total world exports in volume in 2009. This is followed Thailand at 16.8%, China 6.7% and Indonesia 5.1%.
- Some slowdown for NR glove manufacturers...** Manufacturers with larger exposure to the natural rubber (NR) segment appear to be hit more this year as latex prices scaled all time highs. Nevertheless, most of them continue to believe that this situation is only temporary as it does not mean demand is contracting but rather customers are withholding orders in anticipation of latex prices falling in the coming months. Glove manufacturers believe that there could be a strong rebound in demand once latex prices starts to fall. On top of that, it is estimated that rubber glove demand has grown between 20-25% this year as compared to early last year or before the H1N1 situation came about. For 2010, rubber gloves demand is still expected to grow by an average of 8-10%.
- ...but overall demand remains healthy.** For players with more exposure to the nitrile segment, i.e. Hartalega and Latexx Partners, demand remains firm as these companies enjoy an increase in the number of users of nitrile as more are switching to nitrile gloves partly due to the high cost of NR gloves. We expect these players to continue reporting strong margins in the upcoming quarters.
- Earnings are still set to grow this year.** Although there are currency and cost challenges to overcome this year, the resilient prospects of rubber gloves will enable manufacturers to pass on rising costs. As a result, we believe rubber glove companies will continue to report healthy earnings growth this year and in the coming years.

Sector comparisons

	Bloomberg ticker	Recom.	Price (Local)	Target price (Local)	Mkt cap (US\$ m)	Core P/E (x)		3-yr EPS CAGR (%)	P/BV (x)	ROE (%)	Div yield (%)
						CY2010	CY2011		CY2010	CY2010	CY2010
Adventa	ADV MK	O	2.40	4.10	118	10.2	8.0	26.9	1.4	15.4	1.8
Hartalega	HART MK	O	4.70	8.48	554	9.7	8.2	18.2	3.7	44.6	3.5
Kossan	KRI MK	O	2.97	6.08	308	7.3	5.8	15.6	2.0	31.3	3.0
Latexx	LTX MK	O	2.44	5.44	172	5.3	4.1	43.9	2.0	46.0	3.3
Supermax	SUCB MK	O	3.79	9.50	417	6.1	5.3	24.4	1.7	32.4	2.5
Top Glove	TOPG MK	O	5.13	8.90	1,028	10.7	9.5	26.5	2.8	28.9	3.8
Simple average						8.2	6.8	25.9	2.3	33.1	3.0

O = Outperform, N = Neutral, U = Underperform, TB = Trading Buy and TS = Trading Sell
 Source: Company, CIMB Research

Please read carefully the important disclosures at the end of this publication.

Background

On 28-29 September, we attended the 5th International Rubber Glove Conference & Exhibition (IRGCE) in Kuala Lumpur. This is the first time we attended the conference and this year's theme is "Gloves - The Frontline of Barrier Protection". The conference was officiated by Minister of Plantation Industries and Commodities, Tan Sri Bernard Giluk Dompok. President of the Malaysian Rubber Glove Manufacturer's Association (MARGMA), Mr. Lee Kim Meow who is also the Managing Director of Top Glove gave the welcoming remarks. The conference drew some 500 participants from 25 countries, much larger than 2008's crowd of 460 participants from 17 countries. Since its inception in 2002, the biennial conference has become an important forum to connect suppliers, customers, manufacturers, associations as well as regulating bodies to update industry players on the latest development in the rubber glove market.

Highlights

Gloves - The frontline of barrier protection. The theme for the 2010 rubber glove conference is well suited for the current environment where demand for gloves, especially medical gloves, has increased tremendously on the back of rising healthcare awareness and recent outbreak of diseases especially in emerging markets. On top of that, gloves are also widely used to protect a wide range of hazards in the workplace and include electrician gloves, cleanroom gloves, food-handling gloves, industrial gloves and household gloves. The conference attendees include leading regulatory experts, material specialists, R&D personnel and industry players.

88 exhibition booths. There were 88 exhibition booths at IRCGE 2010, 26% more than 2008's 70 booths. Out of this, there were a total of 11 glove manufacturers including five of the six companies that we cover which are Hartalega Holdings, Kossan Rubber Industries, Latexx Partners, Supermax Corporation and Top Glove. The other players include Cranberry (M) Sdn Bhd, Longcane Industries Sdn Bhd, Perusahaan Pelindung Getah (M) Sdn Bhd, Riverstone Resources Sdn Bhd, Titi Glove Sdn Bhd and YTY Group of Companies. Besides gloves, the exhibition also showcased the latest products and services by a host of suppliers including chemicals, machinery and equipment, raw materials, packaging materials and publications.

Paper presentations. A total of 17 speakers presented technical papers under three categories; 1) Regulation & Standards (five speakers), 2) Innovation (seven speakers) and 3) Competitiveness (five speakers). Regulation & Standards cover the different regulations in key market segments, i.e. US and Europe, and gave updates on medical device testing and the impact of such standards on the glove industry. The Innovations segment covered the technical aspects of manufacturing a glove, the advancement of glove technology as well as updates on the latex allergy in medical gloves. It has been identified that continuous R&D in production process, new materials and new technology have been an integral part of the glove manufacturing process to ensure the quality and reliability of the glove products. We were most interested in the last segment of paper presentations which is on Competitiveness, which covers trends in global rubber glove trade, demand and supply trends for rubber as well as environmental aspects such as carbon footprint and green energy opportunities for the glove industry.

MREPC session

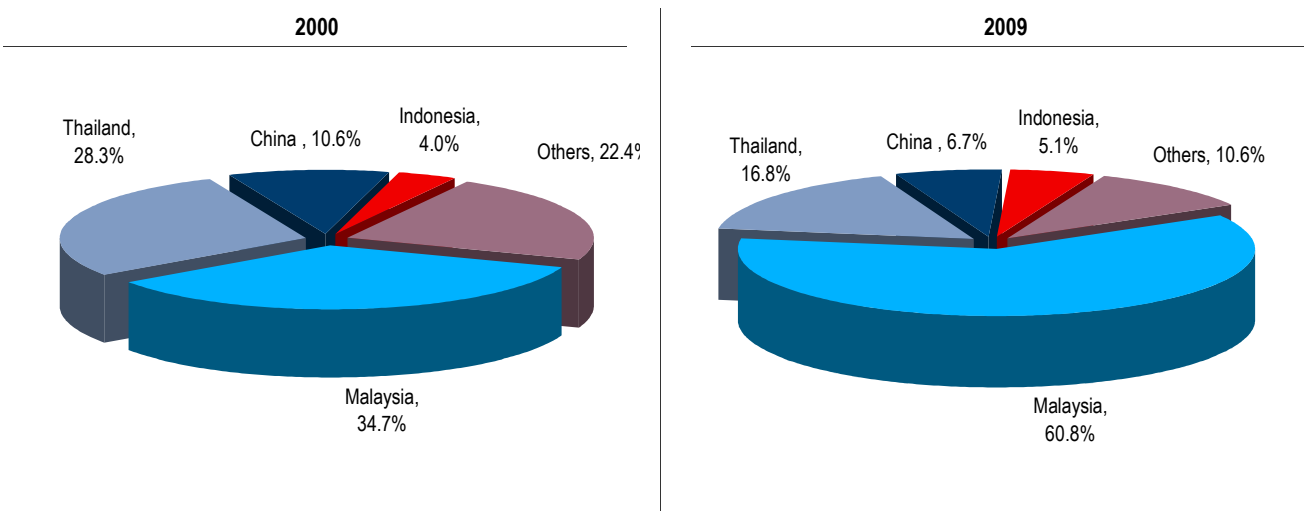
MREPC session. The two papers presented at the conference that we were most interested in were the ones by the Malaysian Rubber Export Promotion Council (MREPC) and the International Rubber Study Group (IRCG). MREPC presented a paper on "Trends in Global Rubber Glove Trade" which highlighted growing usage of gloves and the key markets.

Malaysia still dominates. In 2009, a total of 69.8bn pairs or 139.6bn pieces of gloves were exported globally. This is 10.8% higher than 2008's figure of 63bn pairs or 126bn pieces. For 2010, rubber gloves demand is still expected to grow by an average of 8-10%. MREPC highlighted that Malaysia continues to dominate the world rubber gloves market by capturing about 60.8% of total world exports in volume in 2009 (Figure 1). This is a huge success compared with the country's market share in

2000 of only 34.7% and shows that the Malaysian glove makers are well ahead of their competitors in its glove products and facilities as economies of scale achieved over the past decade has allowed them to offer high quality products at competitive prices

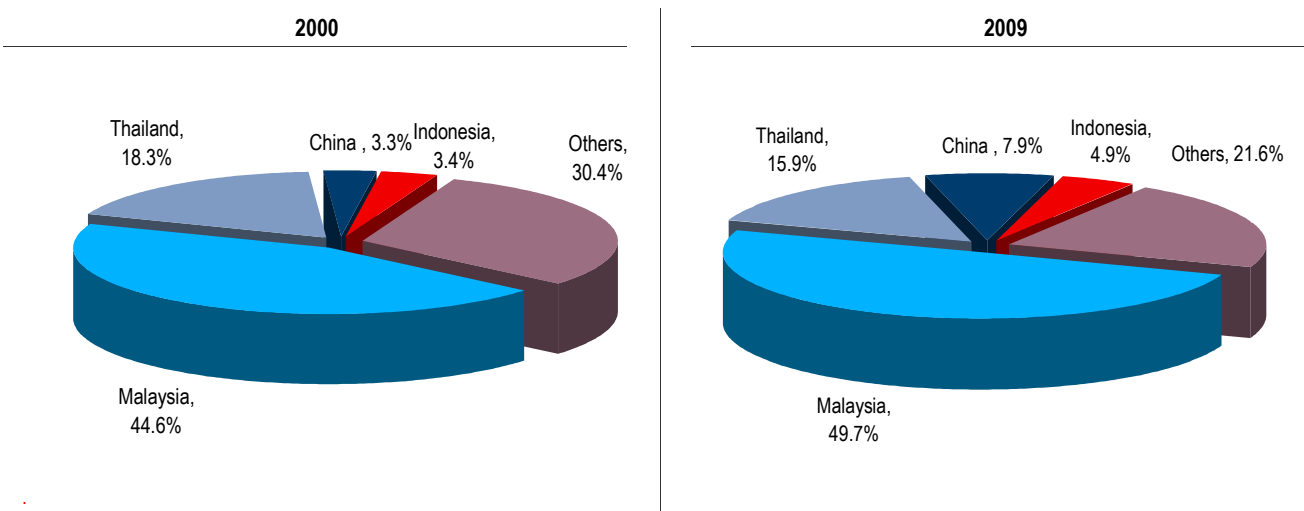
Comparison in terms of value. In terms of value, the total world rubber glove exports amounted to US\$4.1bn in 2009, 5% below 2008 export figures of US\$4.3bn. However, we noted that value can be distorted by different selling prices especially due to the volatility of raw material prices. Recall that latex prices averaged at 570.8sen/kg in 2008 as compared to 447.8sen/kg in 2009. Thus, MREPC said volume or quantity exported should be used as a better gauge for the total world market for gloves. For comparison purposes, MREPC highlighted that even in value terms, Malaysia still has the number one position of glove exports with 49.7% share in 2009 (Figure 2) followed by 15.9% share by Thailand, 7.9% share by China, 4.9% share by Indonesia and balance of 21.6% are made of other countries with smaller market share.

Figure 1: World's rubber glove exports by country – share of quantity



Source: MREPC

Figure 2: World's rubber glove exports by country – share of value



Source: MREPC

Majority of gloves exported are still made of natural rubber. As of 1H10, 72% of Malaysia's rubber glove exports were natural rubber (NR) gloves and 28% were synthetic rubber (SR) gloves. Out of the 28% of synthetic rubber gloves, 90% is made up of nitrile gloves while the balance is made up of other synthetic materials such as vinyl and PVC gloves.

Increasing preference for nitrile glove. MREPC also highlighted that nitrile gloves have been growing in importance, complementing the natural rubber gloves in a challenging global market. Interestingly, US is the only country where the synthetic glove market is larger than the natural rubber glove market at 51% vs. 49%. This is

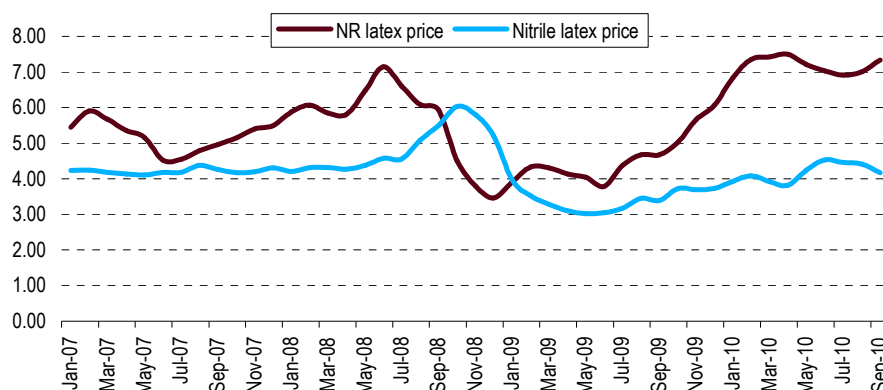
mainly due to the concerns regarding latex allergy in NR latex properties.

IRSG session

IRSG session. The International Rubber Study Group (IRSG) senior economist No Dock Mung presented on “Demand and Supply Trend and Forecast of Natural and Synthetic Rubber, and the Effects on the Glove Industry.” According to No, world rubber consumption is expected to grow 12% to 23.7m tonnes in 2010. The growth assumption was based on, among others, the vehicle and tyre sector data, crude oil forecast, synthetic rubber data and rubber demand data. By 2020, the IRSG estimates world rubber consumption to hit 31.5m tonnes, of which tyres would take up 63% and general rubber goods about 37%.

New plantings to accommodate growing demand. IRSG highlighted that the direction of the rubber prices is difficult to predict. However, given the strong demand currently and tight supply in the market, prices are set to remain at high levels. Nevertheless, IRSG also highlighted that between 2005-2008, there have been new plantings in the Asia Pacific region with more than 1m hectares added. This should support the growing demand for rubber.

Figure 3: Latex price trend (RM/kg)



Source: Bloomberg, Company

Updates on the glove companies

During the two-day conference, we also managed to catch up with a few of the big industry players. Our key takeaways from this are as follows:

Hartalega

Hartalega has not seen any slowdown in demand. As more than 80% of the group's sales goes to the nitrile glove market where raw material prices are less volatile than NR prices, demand for their products remain intact. On top of that, the company mentioned they have even managed to secure new customers recently. Hartalega said it was able to offer competitive prices to its existing and new customers due to greater economies of scale from its new plant. Accordingly, its profits should improve in the coming quarters supported by growing demand for nitrile and additional capacity coming on. Their main concern would be the weakening US\$ but they reiterated that they should be able to raise their prices, with a time lag of 1-2 months to maintain their margins.

Latexx Partners

Latexx Partners remains firm on its plans to move into the premium segment, i.e. powder-free NR gloves and nitrile gloves where it sees significant growth potential. The company has experienced some slowdown in its powdered segment but mentioned that this has allowed them to produce more nitrile gloves where demand continues to grow. Latexx also indicated that they have seen strong response for its protein-free glove segment. Some customers have also showed interest in sending over their products to be treated using Total Glove's (the JV company set up by

Latexx and Budev, which owns the patent to the washing method) washing method to remove the protein content to undetectable levels under the FitKit method. There have also been some enquiries for washing of surgical gloves and condoms using the same machine. Currently, Latexx is still operating the washing system using the test machine but the large scale machine with a capacity to wash 120,000 pieces per hour is expected to come onstream in 4Q. The company expects strong contribution from this segment next year.

Supermax

Supermax confirmed that there has been some slowdown in demand but their orders are still healthy and utilisation rates are still running high at about 85-90%. It remains firm on its expectations that sales volumes will continue to grow over the next few quarters as well as keeping its long term expansion plans intact with its Glove City project. On top of that, the group is also focusing on its R&D activities to develop and improve its glove products. It expects to launch some new products next year.

Top Glove

More than 50% of Top Glove's products are in the lower-end segment, i.e. powdered gloves. The company has seen a big slowdown in orders as its production utilisation is currently running at about 70-75% as compared to 90-95% during the peak of H1N1 last year. Nevertheless, taking into account normal demand growth, the group mentioned that its glove orders have actually increased by about 20% as compared to the pre-H1N1 period.

As latex prices continue to trade on the high side, customers especially those in the powdered segment continued to withhold orders or are ordering minimal quantities in anticipation of latex prices falling. Management also predicts that some customers might still have a lot of stock in hand after restocking at high levels during the H1N1 crisis.

Top Glove is scheduled to release its 4QFY8/10 results on 6 Oct. Judging from the continuation of high latex prices, weakening US\$ and potential lower demand during Jun-Aug, we expect the group to report a weaker qoq earnings. Full year earnings are likely to miss our full year estimate of RM283m by at least 10% as we had expected 4Q to be similar if not better than 3Q. In light of this, we are likely to revise our FY11-12 numbers downwards by 10-15% when the company announced its results next week.

Key takeaways from conference

Key positives. Although there were no major surprises, there were a lot of significant positives that we took away from the rubber glove conference. Gloves, especially medical gloves have clearly become a necessity in healthcare usage as it acts as a barrier protection for medical personnel and patients. Strict regulations, standards and technical aspects of gloves also create a higher barrier to entry for newcomers into the industry.

Volatile latex prices and weakening US\$ remain a concern. The volatility of latex prices and weakening US\$ remain the most pressing concerns for the rubber glove manufacturers. Nevertheless, we were reassured that most of such costs can be passed on any margin contraction would be minimal and temporary. More importantly, we believe that demand growth is strong enough to support the glove manufacturing business and investors should still see yoy growth in their earnings this year.

Some slowdown for NR glove manufacturers... Manufacturers with larger exposure to the NR segment seem to be hit more this year as latex prices hit all time highs. Nevertheless, most of them believe that this situation is only temporary as it does not mean demand is contracting but instead customers are withholding orders in anticipation of falling latex prices in the coming months. Glove manufacturers expect a strong rebound in demand once latex prices starts to fall.

...but overall demand remains healthy. For players with more exposure to the nitrile segment, i.e. Hartalega and Latexx Partners, demand remains firm as these companies enjoy an increase in the number of users of nitrile as more are switching to nitrile gloves partly due to the high cost of NR gloves. We expect these players to

continue reporting strong margins in the upcoming quarters.

Figure 4: Product mix

	Powdered	Powder-free	Nitrile	Others
Adventa				
=> Surgical	65%	27%	8%	-
=> Dental & examination	40%	55%	5%	-
Hartalega	4%	14%	82%	-
Kossan Rubber	20%	42%	38%	-
Latexx Partners	17%	43%	40%	-
Supermax	42%	35%	20%	3%
Top Glove	57%	24%	7%	12%

Source: Companies

Valuation and recommendation

No change to earnings forecast for now. The conference ended on a high note. Demand for rubber gloves is set to grow further led by the growing usage of medical gloves. However, the volatile movement of latex prices and fast weakening of US\$ continues to be a concern which could lead to further contractions in qoq earnings, especially for the NR glove players. This is not surprising as we have highlighted in our recent rubber glove report (Striking back at the naysayers dated 10 August) that rubber glove manufacturers earnings are likely to contract by one or two quarters every time latex prices hit new high or US\$ weakens as there will be some time lag in price adjustments and change in customers purchasing behaviour. In light of this, we highlight that we might trim our forecasts in the upcoming results announcements to take into account the negative impact. Note that this would likely apply more for the players on the NR segment as we believe nitrile gloves demand is still robust and raw material costs are not as volatile as the NR costs. We have recently cut our forecasts for Adventa and are likely to cut our earnings estimates for Top Glove in its upcoming results. There is also risk to earnings of Kossan and Supermax, but to a lesser degree than Top Glove, due to their exposure to the NR segment. Nevertheless, we are not overly concerned about the weak quarterly numbers as the rubber glove companies should still show healthy earnings growth this year given that capacity expansion and growing demand should override short-term currency depreciation and latex price trends. Even with the earnings cuts, we are likely to maintain outperform calls on the stocks as valuations would still be attractive.

Maintain OVERWEIGHT. Although there are challenges to overcome, the resilient prospect of rubber gloves will still allow manufacturers to pass on rising costs. With their continued technological advancement of glove products and facilities, we believe Malaysian rubber glove manufacturers will maintain leadership in the global market. In light of the positive longer term prospects of the industry, we maintain our OVERWEIGHT call. All the glove stocks under our coverage remain as Outperforms. The recent pullback in share prices has made the sector even more attractive with undemanding average P/Es of 7-8x. We believe that all the negative news on the sector have been overdone and priced into the stocks as they have fallen between 17-50% from their recent peaks. The sharp pullback in share prices provides investors opportunity to accumulate positions on weakness. Potential re-rating catalysts include the steady uptick in demand from the healthcare industry, ongoing capacity expansion and strong earnings growth. Supermax and Latexx remain our top picks.

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RECOMMENDATION FRAMEWORK #1*

STOCK RECOMMENDATIONS

OUTPERFORM: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 12 months.

NEUTRAL: The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

TRADING SELL: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

TRADING BUY: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 3 months.

TRADING SELL: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 3 months.

* This framework only applies to stocks listed on the Singapore Stock Exchange, Bursa Malaysia, Stock Exchange of Thailand and Jakarta Stock Exchange. Occasionally, it is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.

RECOMMENDATION FRAMEWORK #2 **

STOCK RECOMMENDATIONS

OUTPERFORM: Expected positive total returns of 15% or more over the next 12 months.

NEUTRAL: Expected total returns of between -15% and +15% over the next 12 months.

UNDERPERFORM: Expected negative total returns of 15% or more over the next 12 months.

TRADING BUY: Expected positive total returns of 15% or more over the next 3 months.

TRADING SELL: Expected negative total returns of 15% or more over the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of +15% or better over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, has either (i) an equal number of stocks that are expected to have total returns of +15% (or better) or -15% (or worse), or (ii) stocks that are predominantly expected to have total returns that will range from +15% to -15%; both over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of -15% or worse over the next 12 months.

TRADING BUY: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of +15% or better over the next 3 months.

TRADING SELL: The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of -15% or worse over the next 3 months.

** This framework only applies to stocks listed on the Hong Kong Stock Exchange and China listings on the Singapore Stock Exchange. Occasionally, it is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.