

Gloves

OVERWEIGHT (maintain)

Absolute Performance (%)

	1M	3M	12M
Kossan	-10.9	+0.5	+136.7
Hartalega	-7.7	-11.8	+34.1
Supermax	-15.1	+5.8	+42.6
Top Glove	-15.0	-11.5	+2.8

Source: Bloomberg

	Target price (RM)		Rating	
	Prior	Revised	Prior	Revised
Top Glove*	5.10	5.10	REDUCE	REDUCE
Supermax	3.25	3.25	ADD	ADD
Kossan	5.08	5.08	BUY	BUY
Hartalega	7.75	7.75	ADD	ADD

Source: Affin

Note: summary of our recent rating and TP changes

Oversupply not yet an issue

Stock prices have fallen across the board

Stock prices for the Big 4 Malaysian-based glove manufacturers (Top Glove, Supermax, Kossan, Hartalega) have declined over the past two days. TOPG's share price has been hit the hardest, falling by 10%, followed by Hartalega (-5.6%), Supermax (-3.4%) and Kossan (-6.7%). We believe that the declines were triggered by TOPG's statement about an oversupply in the nitrile segment during its 2Q FY14 results announcement on 20 March.

Refuting the oversupply issue

TOPG reported weak 2Q FY14 results, with revenue down 5% yoy and net profit down 22% yoy. Management attributed this to lower-than-expected selling prices due to weak demand for its natural rubber gloves products and high nitrile supply. While we agree that demand for TOPG's latex-based gloves is experiencing contraction, we think the claims of high nitrile supply are less accurate. Our channel checks with other glove manufacturers indicate that production facilities are still busy, including nitrile production lines. Hartalega's production facilities are running at optimal levels, with utilization rates of 88-90%, while Kossan's rate remains 85% and Supermax's remains 83%. Plant expansions for these glove manufacturers are also on track. This suggests that weak demand for TOPG's nitrile gloves is peculiar to the company, possibly due to its late expansion into the nitrile segment. We believe there is no oversupply issue, and that oncoming supply can be absorbed by growing demand.

Nitrile gloves sales to top 10 export countries grew 8.5% in 2013

The official 2013 annual report from the Malaysian Rubber Export Promotion Council (MREPC) has yet to be published, but we gather from industry sources that the number of gloves sold to Malaysia's top 10 export destinations grew by 8.5% yoy to 44.3bn pieces in 2013. By segment, Nitrile glove exports to the 10 countries is believed to have grown by 18% yoy to 19.3m pairs, while exports of latex-based gloves have fallen by 0.4% yoy to 12.3m pairs. This supports our investment thesis that nitrile gloves are still preferable in developed markets, despite a smaller pricing mismatch between the latex and nitrile commodities due to the benefits of the latter.

Good time to BUY

We think this is a good opportunity for investors to accumulate. On a whole, we remain positive on the sector backed by: 1) favourable raw material cost; 2) resilient demand from developed and developing economies; 3) improving production efficiencies; and 4) a stable US dollar against the RM, which would help to spur the nation's export market. Deemed as a staple product in the healthcare industry, we believe demand for rubber gloves will remain resilient, growing in tandem with world population growth and spurred by an increase in usage at healthcare centres globally. To cater to the strong demand, the Big 4 have put in place strategic expansion plans, which include the desirable number of production lines, machinery for automation processes, improved R&D, cost structure, and product development.

Maintain OVERWEIGHT; Kossan remains our top pick

Among the Big 4, TOPG is our least preferred name. While its share price has fallen below our price target, we keep our REDUCE rating under review pending a meeting with management. All in, we reiterate our **OVERWEIGHT** rating on the gloves sector. Our top pick remains **Kossan (KRI MK, BUY, RM5.08)** as we think it has the most balanced and favourable product mix and attractive valuation relative to peers. Key risks would be: 1) a sharp spike in latex price; and 2) stiffer-than-expected price competition, leading to margin erosion.

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Fig 1: Valuation matrix for glove companies

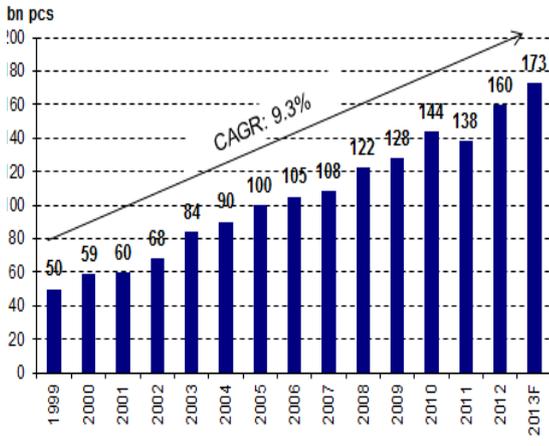
Stock	Rating	Sh Pr (RM)	TP (RM)	Shares out	Mkt Cap (RMm)	Year End	Core PE (x)		EPS growth (%)		EV/EBITDA (x)	P/B (x)	ROE (%)		Net Div Yield (%)	
							CY14	CY15	CY14	CY15			FY14	FY15	FY14	FY15
Kossan	BUY	4.01	5.08	639.5	2,564	Dec	14.3	12.0	27.2	19.7	8.3	2.3	18.5	18.7	2.2	2.7
Top Glove	REDUCE*	4.93	5.10*	620.6	3,059	Aug	14.5	11.4	0.4	5.5	8.2	2.5	15.8	17.0	3.2	3.4
Supermax	BUY	2.58	3.60	679.2	1,752	Dec	12.2	11.2	11.2	9.6	11.4	1.7	14.7	13.5	2.3	2.7
Hartalega	ADD	6.40	7.75	746.9	4,780	Mar	15.0	13.8	16.2	16.6	11.5	6.5	31.3	30.3	2.3	2.8
Simple average							14.0	12.1	13.7	12.8	9.8	3.2	20.0	19.9	2.5	2.9

*Under Review

Source: Bloomberg, Affin forecasts

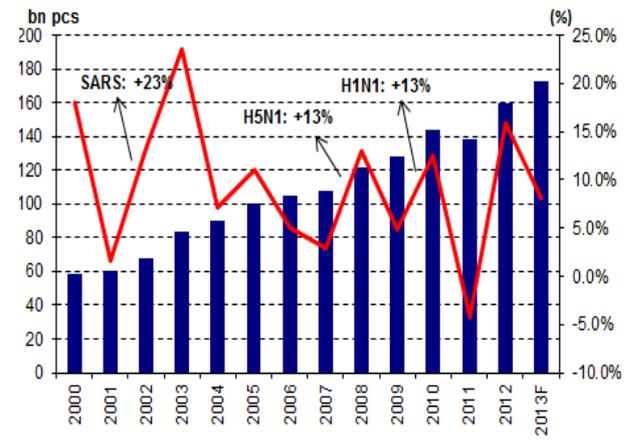
FOCUS CHARTS

Fig 2: Global annual demand for gloves



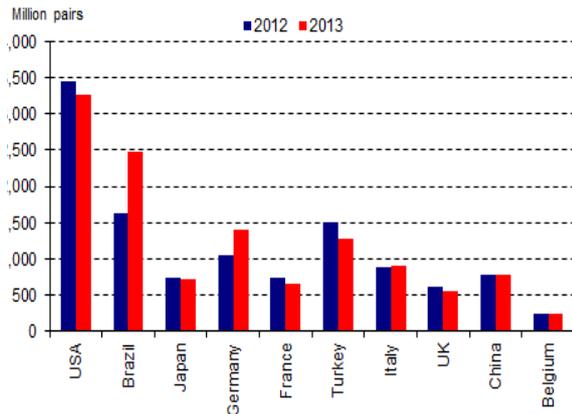
Source: MREPC, Affin forecasts

Fig 3: Global demand (LHS) and growth (RHS)



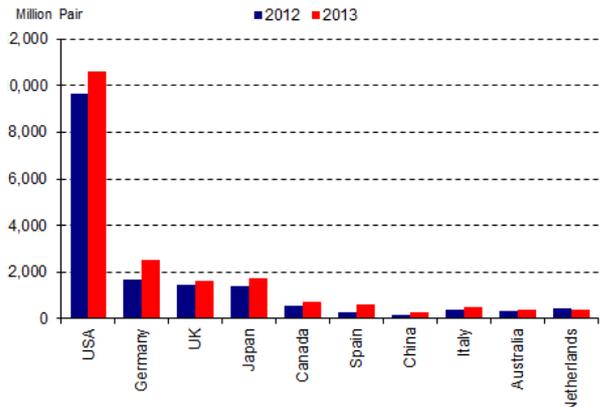
Source: MREPC, Affin forecasts

Fig 4: NR-based gloves export to top 10 destinations



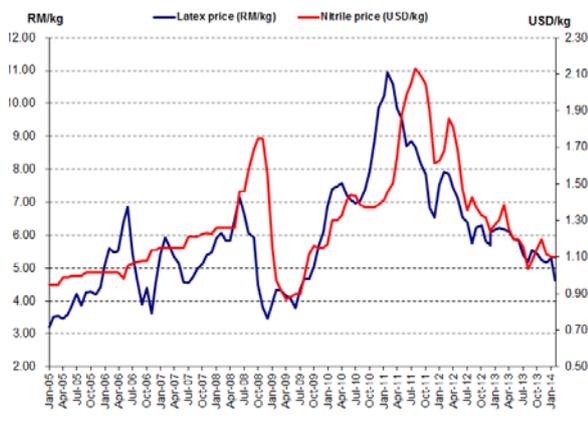
Source: MREPC, Affin

Fig 5: Nitrile-based gloves export to top 10 destinations



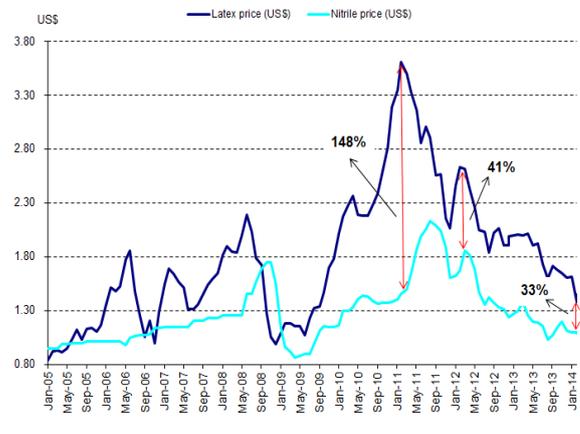
Source: MREPC, Affin

Fig 8: Latex price vs nitrile price



Source: Bloomberg, Affin

Fig 9: Price disparity gap between the two raw materials



Source: Bloomberg, Affin

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +15% over a 12-month period
TRADING BUY (TR BUY)	Total return is expected to exceed +15% over a 3-month period due to short-term positive development, but fundamentals are not strong enough to warrant a Buy call. This is to cater to investors who are willing to take on higher risks
ADD	Total return is expected to be between 0% to +15% over a 12-month period
REDUCE	Total return is expected to be between 0% to -15% over a 12-month period
TRADING SELL (TR SELL)	Total return is expected to exceed -15% over a 3-month period due to short-term negative development, but fundamentals are strong enough to avoid a Sell call. This is to cater to investors who are willing to take on higher risks
SELL	Total return is expected to be below -15% over a 12-month period
NOT RATED	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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