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Friday, June 12, 2015

Market Access

Rubber Gloves Sector
(Overweight)

"Improving Rubber Price"

Table 1: Rubber Gloves Sector Operational Metrics Forecast

	2014	2015F
GDP	5.8%	5.0%
RM per USD	RM3.17	RM3.40-RM3.50
Inflation	3%	4%-5%
Capacity (billion pcs)	94	102 (9%)
Average Natural Rubber (RM)	4.37	3.63 (YTD 3.98)
Average Nitrile (USD)	1.09	1.05 (YTD 0.95)
Top Pick	Supermax (BUY; TP: RM2.28)	

Source: M&A Securities

Table 1: Natural Rubber and Nitrile Price Movement

	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15
Natural Rubber						
USD	1.64	1.46	1.44	1.33	1.13	1.10
RM	5.26	4.81	4.65	4.25	3.77	3.93
MYR/USD	3.21	3.29	3.23	3.19	3.28	3.58
Nitrile						
USD	1.14	1.11	1.05	1.12	1.09	0.92
RM	3.65	3.64	3.40	3.56	3.50	3.61
MYR/USD	3.21	3.29	3.23	3.19	3.28	3.58

Source: Company, M&A Securities

Table 2: Rubber Gloves Capacity by Player (2014-2016F)

Billion Pcs	2014	2015F	2016F	Growth (Y-o-Y)
Hartalega	13	15	22	46%
Kossan	16	18	24	33%
Supermax	22	24	26	8%
Top Glove	43	45	50	11%
Total	94	102	122	20%

Source: M&A Securities

We have an Overweight call on rubber gloves sector anchored by 1) rising demand from advanced countries due to solid hygiene concerns, 2) potential strengthening of USD 3) neutral impact of GST, 4) cost easing, emanating from global commodity price softness and 5) robust capacity expansion by major rubber glove players. However, we are concern that our positive view may hit drawbacks due to stiff competition in the nitrile segment, hike in natural gas and electricity prices and lower average selling price. Notwithstanding that, we continue to like Supermax (BUY; TP: RM2.30) for its: i) Supermax Business Park with an estimated of 40 production lines and production capacity of 15.5 billion pieces per annum and ii) diversifying its revenue stream into the contact lens business, with a profitable gross profit margin of up to 60%. We have a HOLD call on Hartalega, (TP: RM7.40), Top Glove, (TP: RM5.61) and Kossan (TP: RM6.12).

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Moving forward, the rubber glove sector remains bullish moulded by capacity expansion as the demand for gloves to remain strong despite the drop in average selling price due to the softening of global commodity prices. Rubber prices are expected to be stable anchored by the collaboration of six countries, namely Malaysia, Thailand, Indonesia, Cambodia, Laos PDR and Myanmmar to strengthen the rubber prices. In a nutshell, the followings are the catalysts for the sector.

1) Capacity Expansion.

The rubber glove sector is heading into positive direction as demand for rubber glove will remain steady due to escalating hygiene concerns. Taking advantage of this, all rubber glove players have ramped up their production capacity, especially in the nitrile segment and have begun commissioning their newly installed production lines. Top Glove and Hartalega are currently the leading players in nitrile segment with production capacity of 10 billion and 14 billion pieces per annum. Top Glove's product mix for nitrile and natural rubber gloves are in the ratio of 50:50, while Hartalega, the ratio is at 92:8. Note that Hartalega's NGC has been operating since the beginning of the year where at the moment there are 8 production lines running.

Hartalega aims to commission two production liner per month and estimate that the first two of 12 lines to be completed by 1Q16. As for Top Glove, the group is eyeing on merger and acquisition (M&A) to expand its business by investing/acquiring companies that are involved in packaging material or glove machinery. As for Kossan, the company is expected to ramp up its nitrile capacity to its targeted product mix ratio of 70:30 in FY15 compared to approximately 60:40 currently. In tandem with the expansion in nitrile gloves, Supermax has also replicated this strategy to increase its nitrile capacity by 12.3 billion pieces per annum (+71% y-o-y) from 6.9 billion pieces per annum.

Therefore, we expect that both Hartalega and Top Glove to report better earnings this year, driven by the expansion plans of their nitrile capacity as nitrile glove is strongly demanded from the U.S. and Eurozone, along with the rising healthcare awareness.

2) Raw Material Prices Concerns

Both natural rubber and nitrile prices have dropped by about 18% y-o-y and 17% y-o-y respectively since 1Q14 from RM4.81 per kg and USD1.11 per kg to RM3.93 per kg and USD0.92 in 1Q15. The weakening of natural rubber and nitrile trading at its lowest were caused by global rubber glut due to falling international demand, coupled with weakening in crude oil prices and Ringgit. Moreover, the demand and the price of natural rubber could fall further due to negative sentiment arising from China's slower economy that is likely to grow around 7% in 2015, (FY14: 7.4%). Prices of raw materials would down fall as China is the world's top rubber importer. However, we estimate that these worries would be offset by the relationship and cooperation from the six members of the International Tripartite Rubber Council (ITRC) including Thailand, Indonesia, Malaysia, Cambodia, Lao PDR and Myanmar to strengthen natural rubber prices. Secretary – General Secretary of Malaysia-based Association of Natural Rubber Producing Countries (ANRPC), Sheela Thomas said that rubber prices will possibly increase as global economy improves. Furthermore, the ITRC has taken the initiative to stem the fall in rubber prices by limiting supply and International Rubber Consortium (IRCo) expects that when winter season sets in, rubber price will rebound.

We are positive that cheaper input cost would be a plus point for rubber gloves players as bottom line for rubber glove players would improve in tandem.

3) USD strengthening.

We estimate other glove makers to report good sets of 1H15 numbers underpinned by the strengthening of USD against MYR. Furthermore, the strengthening of the USD will weigh on commodity prices, which will be good in lowering its unit cost. YTD, the USD had risen by 13% against the RM to RM3.69 per USD from RM3.28 per USD. A depreciating in ringgit against the dollar is positive for rubber gloves players since sales are mainly in USD where it will lead to more revenue receipts for glove makers.

4) Demand and Production to rise.

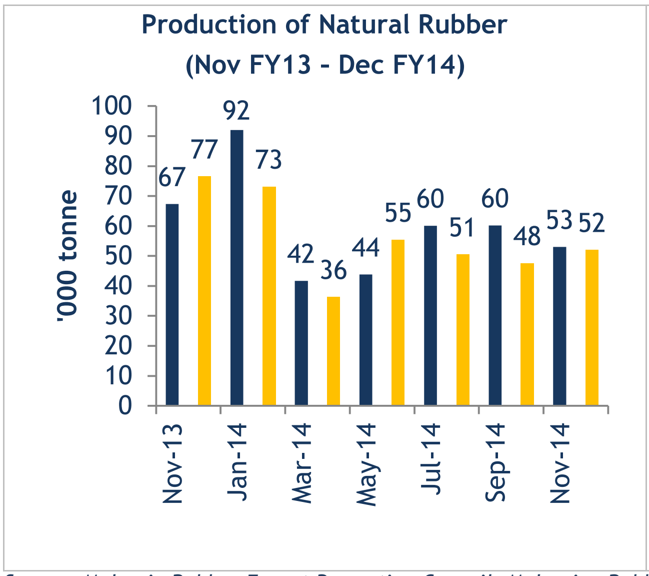
As for the demand side, moving forward in the rubber industry, the Secretariat of the International Rubber Study Group (IRSG) estimates the total rubber demand would show a marginal growth of 1.8% y-o-y and 4.1 y-o-y% in FY15 and FY16 (FY14: 4.1% y-o-y) to 29.1 million tonnes and 30.3 million tonnes. Therefore, production and output are estimated to grow too, taking advantage of the increase in demand of rubber gloves. ANRPC expects production of natural rubber (NR) and synthetic rubber (SR) to increase by 3% y-o-y and 5% y-o-y growth in FY15 to approximately 12.2 million tonnes and 17.6 million tonnes (FY14: NR: 11,809 million tonnes; SR: 16,715 million tonnes). The increase in demand and aggressive capacity expansion by the rubber gloves players have led the Malaysian Rubber Board (MRB) to justify that Malaysia rubber's output could growth substantially by 22% y-o-y to 800,000 tonnes in FY15 from 655,000 tonnes in FY14.

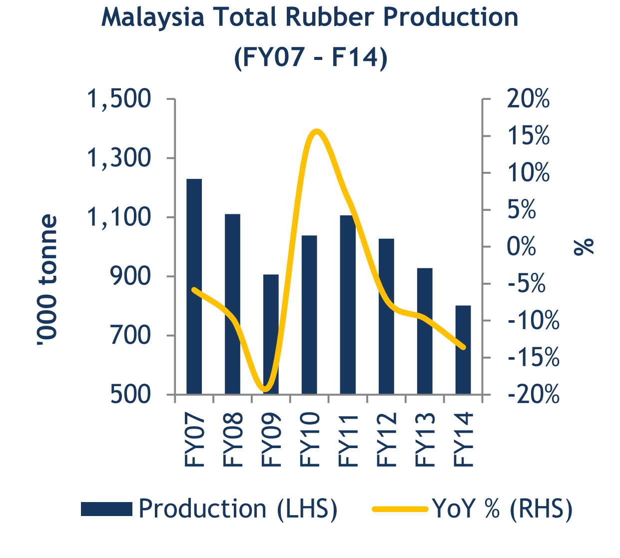
Conclusion and Recommendation. Overall, we are positive on the outlook for rubber gloves driven by new capacity expansion underpin by steady global demand for rubber gloves and escalating hygiene awareness in developed countries. Nonetheless, we estimate the rubber glove players will continue ramping production capacity with moderate pace to avoid any potential oversupply. We have an **Overweight** call on the sector driven by 1) steady demand from advanced countries, 2) potential strengthening of USD 3) neutral impact of GST and 4) cost easing emanating from global commodity price softness as alluded before. We have a **BUY** call on Supermax (TP: RM2.30), lifted by its i) estimated production capacity of 15.5 billion pieces per annum and ii) diversifying its revenue stream into the contact lens business. We also have a **HOLD** call for Hartalega (TP: RM7.40), Kossan Rubbers (TP: RM5.06) and Top Gloves (TP: RM5.61).

Table 3: Peers Comparison

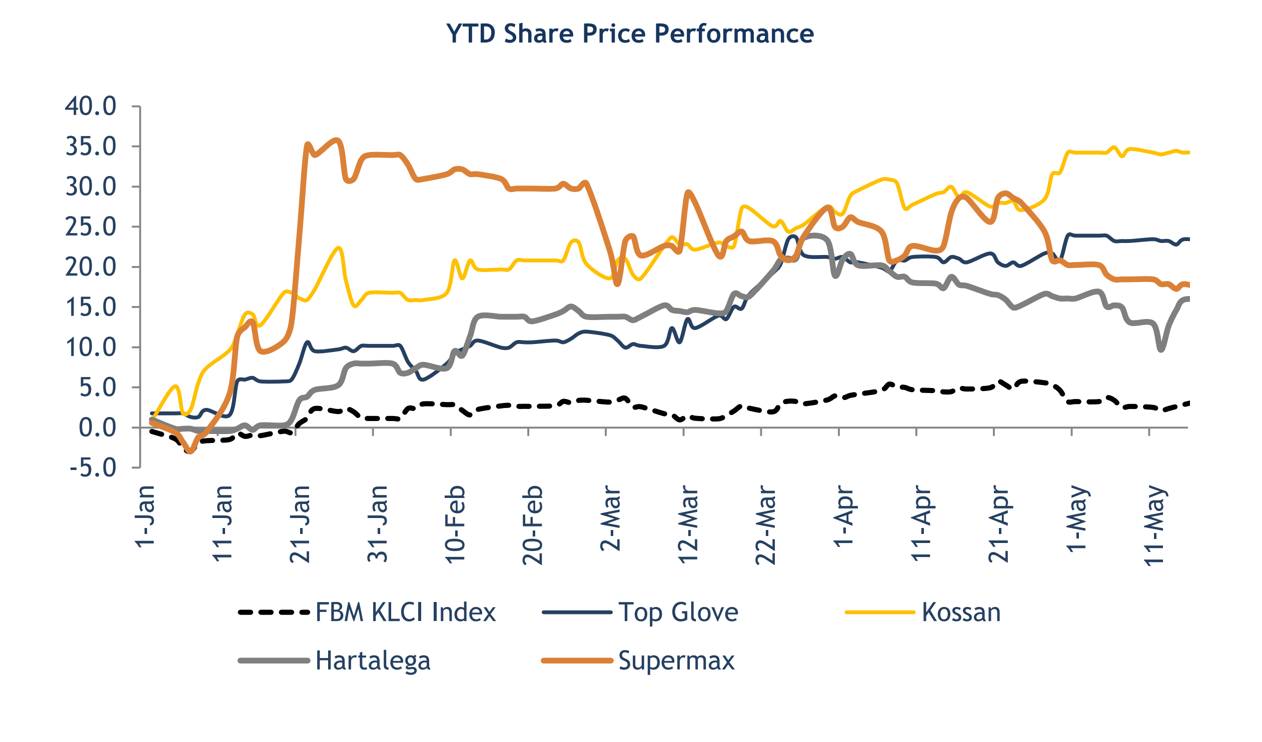
Company	Year Ended	Price (RM)	EPS (sen)		P/E (X)		P/B (X)		ROE (%)	Div Yield (%)	Target Price	Call
			FY15	FY16	FY15	FY16	FY15	FY16				
Top Glove	Aug	5.73	34	36	16	16	2.4	2.5	13.8	2.7	5.61	**Hold**
Supermax	Dec	2.07	19	21	11	10	1.4	1.9	10.8	2.4	2.28	**Buy**
Kossan	Dec	6.67	30	35	20	17	4.8	4.1	19.0	1.3	5.06	**Hold**
Hartalega	Mar	8.84	35	41	23	20	5.2	5.8	19.0	1.5	7.40	**Hold**
Average			29	33	18	16	3.4	3.5				

Source: Bloomberg, M&A Securities





Source: Malaysia Rubber Export Promotion Council, Malaysian Rubber Board, M&A Securities



Source: Bloomberg, M&A Securities

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STOCK RECOMMENDATIONS

BUY *Share price is expected to be ≥+10% over the next 12 months.*
TRADING BUY *Share price is expected to be ≥+10% within 3-months due to positive newsflow.*
HOLD *Share price is expected to be between -10% and +10% over the next 12 months.*
SELL *Share price is expected to be ≥-10% over the next 12 months.*

SECTOR RECOMMENDATIONS

OVERWEIGHT *The sector is expected to outperform the FBM KLCI over the next 12 months.*
NEUTRAL *The sector is expected to perform in line with the FBM KLCI over the next 12 months.*
UNDERWEIGHT *The sector is expected to underperform the FBM KLCI over the next 12 months.*

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