

Rubber Gloves Sector

(Neutral)

“Strengthening USD Boost Glove Players”

Few catalysts will favour the rubber glove sector and hence, we are optimistic the glove sector could bloom in 2015. Rubber gloves' players cost strategy remains largely intact thanks to protracted weakness in global commodity prices. Barring the broader market onslaught, we reiterate our Neutral call on the sector driven by i) the strengthening of USD against RM, ii) no electricity tariff adjustment and iii) steady demand by developed countries. We have a HOLD call on our rubber gloves stocks including Hartalega (TP: RM7.98), Kossan Rubbers (TP: RM6.12), Top Gloves (TP: RM7.74) and Supermax (TP: RM2.28).

Mighty Dollar.

The weakening of Ringgit against the USD would be favourable for rubber gloves players as sales would improve. Ringgit has so far depreciated to RM3.81 on 7th July 2015, the lowest in 16 years, down by 8.14% YTD. Bank Negara governor, Tan Sri Dr Zeti Akhtar Aziz mentioned that the central bank would not defend Ringgit but would only intervene to maintain 'orderly market conditions'. At this current situation against the greenback, ringgit is trading at the same level, during its currency pegging in 1998 or circa RM3.80 per Dollar.

The strengthening of USD will also weigh on commodity prices, which will be a boon for rubber gloves players cost. In addition to earnings that can be lifted due to the strength of USD, the outlook for rubber gloves sector appears intact.

Commodity Prices

When USD is stronger, commodity price will be weakened due to softer demand as it will be expensive to purchase the same amount of goods. Note that, average natural rubber latex price has dropped by 2% q-o-q to RM3.85/kg in 2Q15 from RM3.93/kg from in the corresponding quarter due the weakening of crude oil prices and the drop in ringgit. In addition, nitrile price also declined to USD0.96/kg by 7% y-o-y from USD1.03/kg.

Note that we expect NR price will remain stable in the near term while nitrile price would remain weak due to China's economic deceleration and oversupply of natural rubber. Added with no change in electricity prices until end 2015 and coupled with the previous two catalysts, rubber gloves players should be in good position to deliver good sets of result in 2Q15.

Strong USD leads into steady increase in demand for Malaysian exporter. As Ringgit plunge further, we believe it will not be as calamitous to the Malaysia economy. As Ringgit becomes cheaper, it means that our exports are cheaper and more attractive to the international market, especially to the U.S. market. A favourable USD/MYR exchange rate can potentially lead to a steady increase in demand for Malaysian exports. This is perfect opportunity for Malaysian exporters to establish new long-term business deals for future exports. Basing on this, Hartalega, Top Glove and Kossan Rubber have recorded an upturn in their revenue by 4%/6%/21% y-o-y in 1Q15 due to the sharp appreciation of US currency and lower raw material prices. The drop in raw materials in tandem with oil prices has led to a reduction in production cost. Both factors combined would give the glove players some shield to absorb the rising cost in other areas such as labour and electricity costs (if any).

2Q15 earnings are visible, Higher Earnings Projected. As we expect a descending trend of raw material prices and weakening in Ringgit, we foresee bright 2Q15 earnings prospects for glove players. Capacity expansion plans for all four glove makers are also on track with Kossan adding another 2 nitrile plants to cater for strong demand from existing customers which is expect to be completed by FY17. Meanwhile, Top Glove has started it F29 plant construction and continues to expand by constructing new factories, namely F30 where the management targets it completion by September FY16. Top Glove estimates these factories to add capacity by up to 7 billion pieces per annum (Current: 44.6 billion pieces).As for Hartalega, its Next Generation Complex (NGC) has commissioned to approximately 12 lines with a 13th line coming up. The management foresees capacity would reach approximately 18.4 billion by FY16.

In retrospect, FY14 was a challenging year due to lack of new capacity commissioning and higher operating cost, however, as seen in Kossan's, Top Glove's and Hartalega recent numbers, things have been getting better boosted by enhancement in quality which was aided by greater efficiency and cost control measure in tandem with newer and more efficient glove machineries and factories.

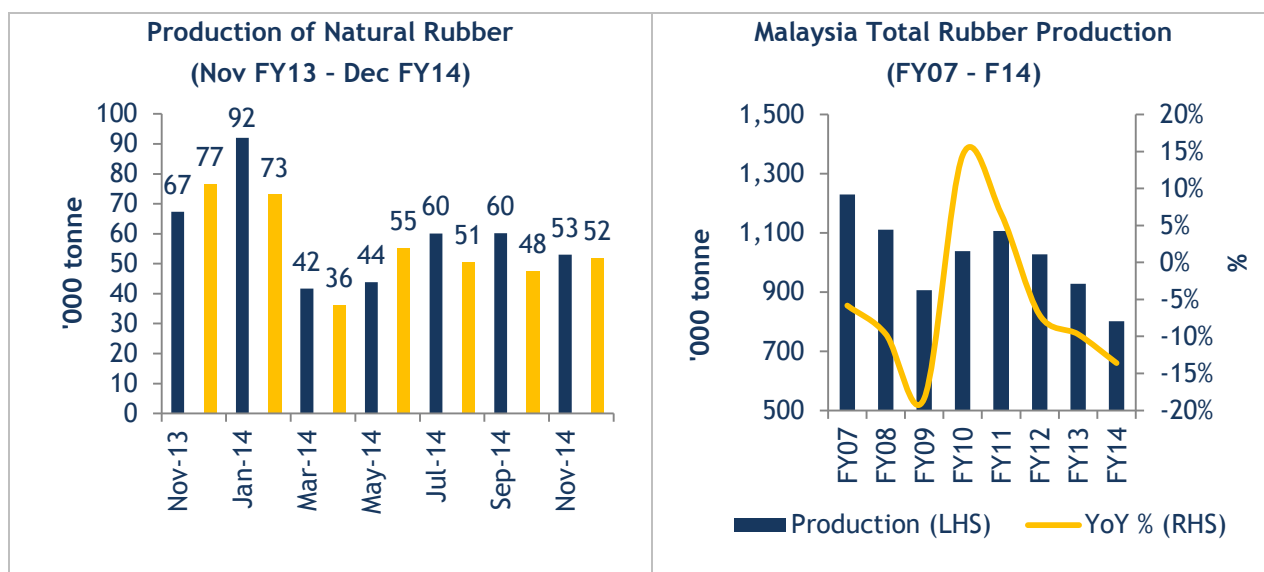
Conclusion and Recommendation. We project Ringgit to stay weaker than RM3.80 for now due to global headwinds and we foresee rubber glove players' earnings could increase correspondingly or by circa 1%-2%. In addition, we expect there will be no further adjustment in utilities and gas prices that could drag earnings and estimate the rubber glove players will continue ramping up production capacity driven by steady rise in demand.

We have a **Neutral** call on the sector driven by 1) steady demand from advanced economies, 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 **HOLD** call on our rubber gloves stocks including Hartalega (TP: RM7.98), Kossan Rubbers (TP: RM6.12), Top Gloves (TP: RM6.84) and Supermax (TP: RM2.28).

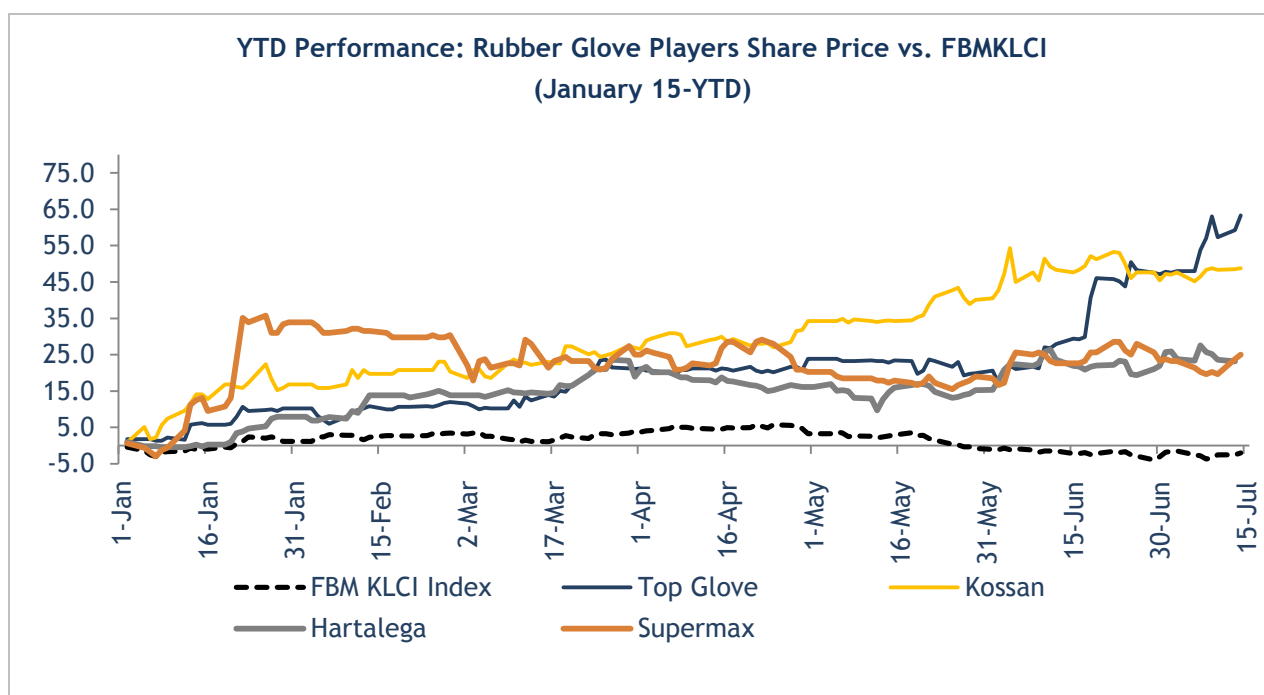
Table 1: Peers Comparison

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	7.42	34	36	16	16	2.4	2.5	13.8	2.7	7.74	Hold
Supermax	Dec	2.10	19	21	11	10	1.4	1.9	10.8	2.4	2.28	Hold
Kossan	Dec	6.64	30	35	20	17	4.8	4.1	19.0	1.3	6.12	Hold
Hartalega	Mar	8.69	35	41	23	20	5.2	5.8	19.0	1.5	7.98	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

M&A Securities

STOCK RECOMMENDATIONS

BUY	Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY	Share price is expected to be $\geq +10\%$ 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 $\geq -10\%$ 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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M & A Securities SdnBhd (15017-H)
 (A wholly-owned subsidiary of INSAS BERHAD)
 A Participating Organisation of Bursa Malaysia Securities Berhad

Principal Office:
 Level 1,2,3 No.45-47 & 43-6
 The Boulevard, Mid Valley City,
 Lingkaran Syed Putra,
 59200 Kuala Lumpur
 Tel: +603 - 2282 1820 Fax: +603 - 2283 1893
 Website: www.mnaonline.com.my