

Rubber Gloves Sector

(Neutral)

“Natural Gas Hike, Electricity Tariff Stays”

Gas Malaysia Berhad (Gas Malaysia) recently announced that the natural gas tariff will be revised for the non-power sector in Peninsular Malaysia, effective 1 July 2015. The gas tariff will be upped to RM21.80/MMBtu from RM19.77/MMBtu previously in 1 November 2014. The hike is due to the higher buying price that it procures from Petroliaam Nasional Bhd (PETRONAS). However, the great news is that the electricity tariff will not be adjusted in Peninsular Malaysia until the end of the year due to the latest review of Imbalance Cost Pass-Through (ICPT).

Natural Gas Hike +10%.

The hike in natural gas will definitely impact the rubber player's bottom line due to delicate and sensitive cost pass-through measures. As mentioned, Gas Malaysia recently announced that the government will revise the natural gas tariff effective 1 July 2015 to RM21.80/MMBtu from RM19.77/MMBtu previously in November 2014. However, the Malaysian Rubber Glove Manufactures Association (MARGMA) is requesting the government to delay the revision of the natural gas tariff by four months. The MARGMA president, Denis Low mentioned that the tariff revision would have an adverse impact to the rubber glove makers' manufacturing cost and stressed that any expected increase in cost should be discussed earlier among the gloves players and not to be implemented on an ad hoc basis. Note that, with the sudden increase of gas price, the glove players have to absorb the cost rather than passing it through, and hence negatively impact the industry players' bottom line. Glove makers in general are able to pass on the gas price hike to the customers, either immediately or within a reasonable time lag depending on when the government announced the hike, as past precedent and customarily practiced.

Table 1: Natural Gas Tariff Schedule

Tariff Category	Average Annual Gas Consumption (MMBtu)	Existing Tariff (RM/MMBtu)	Revised Tariff Effective 1 July 2015 (RM/MMBtu)
A	Residential	19.52	19.52
B	0-600	21.00	20.30
C	601-5,000	18.19	20.40
D	5,001-50,000	18.55	20.60
E	50,000-200,000	19.44	21.50
F	200,001-750,000	19.63	21.50
L	Above 750,000	20.11	22.22
Average		19.77	21.80

Source: Gas Malaysia, M&A Securities

The Malaysian Rubber Products Manufacturer's Association's (MRPMA) president, Datuk Dr Ong Eng Long requests the Minister of Plantation Industries and Commodities and the Minister of International Trade and Industry to intervene on behalf of rubber industry to defer the natural gas

hike. Furthermore, he stressed that there is no valid reason for the price of natural gas to be increased as it is trending down coupled with the current escalating business cost.

Electricity Tariff Remains. It was reported the Energy, Green Technology and Water Ministry has announced the electricity tariff will remain unchanged until end-December 2015. The decision came after the latest revision under Imbalance Cost Pass-Through (ICPT) resulting TNB to post over recoveries amounting RM1.1 billion which is to be passed back to consumer in term of rebates. The latest revision is the continuity from the rebates given from March 2015-June 2015 where TNB's over recoveries reached RM750 million, given the weak coal price circa USD60/MT along with favourable fuel mix resulting from the commencement of Janamanjung Unit 4 and full blown Tanjung Bin Power Plant that utilize coal as main fuel supply. Of note, the cost of electricity comprise on average of 10%-15% the total cost. Hence, we believe that the bottom line of the rubber gloves players would be less pressurised given that the cost of electricity would not be adjusted. Notwithstanding that, we estimate glove manufacturer able to mitigate the impact of higher costs by using biomass energy as an alternative for energy usage.

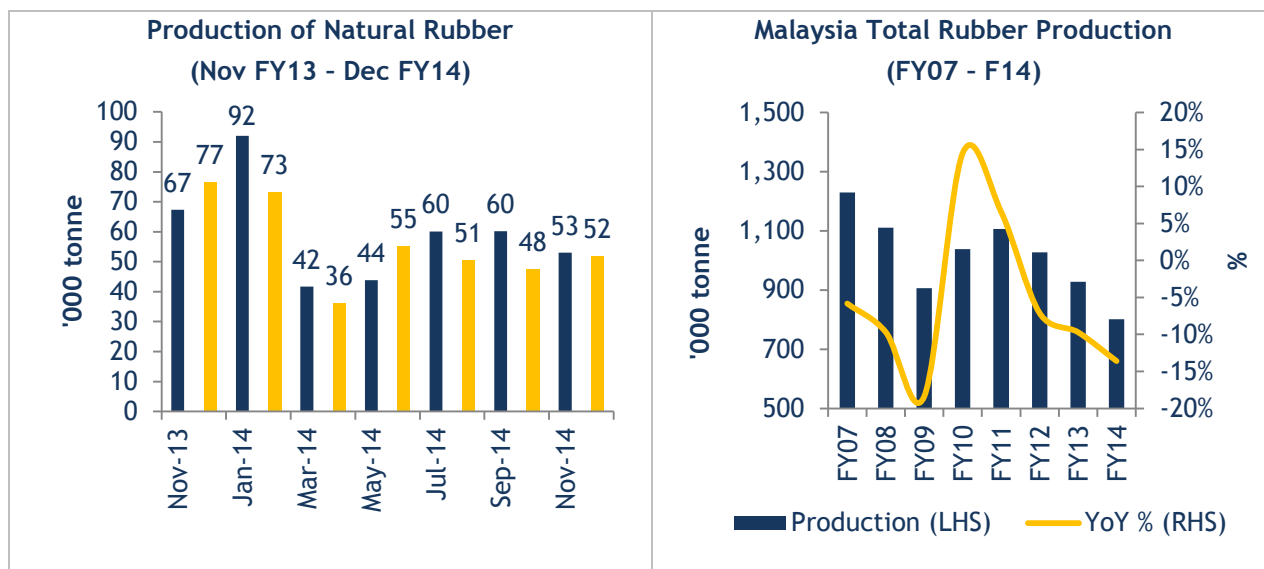
Conclusion and Recommendation. Assuming the natural gas hike would be in region 10%, all rubber glove players' earnings would drop by marginally 1% - 2%, as natural gas cost constitutes approximately 7% (out of 10% of fuel cost) of the production cost. Hence, the price hike would affect the sector and the cost pass-through mechanism would depend on the demand and supply factor whether the cost would be absorbed by the players or passed down to the customers. However, we foresee that the hike in natural gas will be offset by the weakening of ringgit against the greenback which has benefited the industry thus far and the request for the government to push forward the tariff hike to another 120 days. Nonetheless, we estimate the rubber glove players will continue ramping production capacity with moderate pace to avoid any potential oversupply.

We have a **Neutral** 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: RM2.28), 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: RM6.12) and Top Gloves (TP: RM6.46)

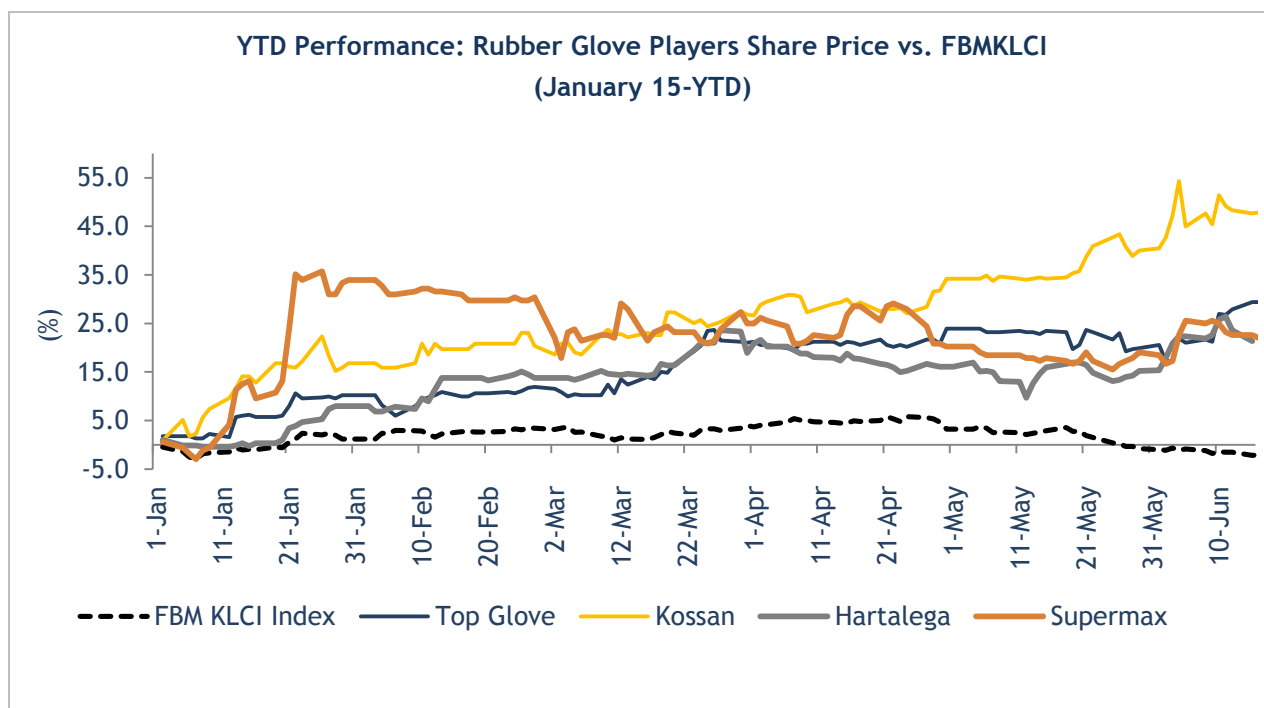
Table 2: Peers Comparison

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	6.67	34	36	16	16	2.4	2.5	13.8	2.7	6.46	Hold
Supermax	Dec	2.11	19	21	11	10	1.4	1.9	10.8	2.4	2.28	Buy
Kossan	Dec	6.60	30	35	20	17	4.8	4.1	19.0	1.3	6.12	Hold
Hartalega	Mar	8.39	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

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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