

## Margins for rubber gloves expand on lower latex price

### Rubber gloves sector

Upgrade to overweight: The recent round of results saw margin expansion for glovemakers on the back of lower raw material costs.

Top Glove Corp Bhd's earnings before interest and tax (Ebit) margin for the third quarter of the financial year ended Aug 31 (3QFY12) grew by 1.6 percentage points (pps) year-on-year (y-o-y), while Supermax Corp Bhd's margins improved by 2.5 pps quarter-on-quarter (q-o-q) and Hartalega Holdings Bhd's by 2.3 pps q-o-q.

Kossan Rubber Industries Bhd's Ebit margin for the second quarter (2Q) ended June 30 was only marginally firmer at 14.3% against 14.2% in 1Q, which we attribute to stronger price competition in its nitrile glove segment.

All in all, aggregate core net profit for Top Glove, Supermax, Kossan and Hartalega grew by 20.5% q-o-q, mainly due to stronger demand and lower natural and nitrile latex costs.

After peaking at RM7.96 per kg in February (during the wintering period), the latex price has plunged by as much as 34% to a low of RM5.27 per kg on Aug 16.

The sharp price decline was triggered by: (i) the end of the wintering period and increase in rubber supply, and; (ii) weaker demand for rubber from China's slowing auto industry. China is the world's largest consumer of natural rubber.

Thailand, Malaysia and Indonesia have prepared to cut exports by 300,000 tonnes to help support prices (starting on Oct 1). It was also agreed that circa 16,000ha of rubber trees would be cut down and replanted, taking another 150,000 tonnes of natural rubber off the market.

Altogether, the 450,000 tonnes account for circa 3% of total global natural rubber production (2011: 11 million tonnes). Since the measures

were announced, the latex price has rebounded by 8.5% to RM5.71 per kg currently.

Nevertheless, given that year-to-date average latex price is now RM7 per kg, our 2012 average latex price assumption of RM7.80 per kg appears high.

In our results notes for Supermax (Aug 22) and Kossan (Aug 24), we had already imputed in a lower average FY12 to FY14 latex price assumption of RM7.15 per kg. This led to a 4% to 6% earnings upgrade for Supermax (Kossan's 8% to 10% earnings downgrade was largely due to lower than expected revenue).

Maintain "add" for Kossan (target price [TP]: RM3.40) and "buy" for Supermax (TP: RM2.55). We now incorporate the lower latex price assumption into our forecasts for Top Glove.

Our FY13/FY14 net profit forecasts are raised by 10% to 12%, while the target price is lifted to RM6.20 (previously, RM5.40, price-earnings ratio [PER] target: 16 times).

Upgrade to "buy". Note that Top Glove is the key beneficiary of lower latex price, as circa 80% of its total glove production is natural rubber gloves.

We make no changes to our FY13 to FY15 forecasts for Hartalega, as circa 95% of gloves produced are nitrile gloves. We believe the share price will continue to be supported by improving investor sentiment on the rubber glove sector.

We maintain our "reduce" recommendation (due to rising price competition in the nitrile glove segment) but raise our target price to RM4.10 (previously, RM3.80), based on a higher PER target of 13 times (one notch higher than our previous target of 12 times).