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MALAYSIA EQUITY
Investment Research
Daily News

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Sector Update

Rubber Gloves

Demand Still Ahead of Supply

OVERWEIGHT

Recently, we invited Supermax Executive Chairman and Group Managing Director Dato' Seri Stanley Thai to give fund managers an update on the rubber glove industry. We gather that demand is still strong as most of the rubber glove manufacturers have sold forward up to September 2010 in spite of the currently high selling prices of gloves reflecting a rise in latex price. Although margins will dip going forward as glove makers only pass on the cost increase to their customers, most importantly the absolute net profit figures will be maintained and therefore EPS and fair values are intact. We remain Overweight on the sector, with our top picks being Top Glove (Buy, TP: RM15.15), Supermax (Buy, TP: RM9.11) and Kossan (Buy, TP: RM11.30).

Annual global demand at 8%-10%. The global annual consumption of medical examination and surgical gloves is expected to reach about 155bn pieces by 2011 from 135bn pieces in 2009, boosted by growing healthcare awareness after the H1N1 pandemic and healthcare reforms in many countries after the recent passing of reforms in US as standards of living improve. Of the total world exports, Malaysia supplies 63% of global demand. Also, about 54% of the global market is shared among the top 6 rubber glove companies listed in Malaysia.

Developed countries still favor powder-free natural rubber medical gloves. Medical grade gloves make up about 85% of Malaysia's total glove exports. The product mix between natural rubber and nitrile gloves is in the ratio 74%:26% while that for powder-free and powdered gloves is 67%:33%. More than 70% of these gloves are sold to developed countries while there is huge potential demand from developing countries like China and India in the coming years.

Latex price and USD strength exert some influence on the industry. Currently, latex price has remained at a high of about RM7.00/kg while the USD is still struggling to regain lost ground against the MYR. Although rubber glove manufacturers can pass on most of the costs associated with these negative factors to their customers, they may experience a time lag in adjusting prices, especially in supplying to non-healthcare MNCs. Nevertheless, as supply still lags demand since most of gloves are sold forward up to September 2010, we believe these 2 factors would not pose a major threat to the rubber glove industry.

Maintain Overweight. We remain positive owing to: 1) continuously strong demand from the medical and hygiene markets; 2) increasing awareness of health and cleanliness following the H1N1 pandemic; 3) the possibility of governments in developing countries making compulsory the use of gloves for the medical sector; 4) a recovery in the global economy and living standards rise, and 5) local rubber glove manufacturers again embarking on capacity expansion to boost revenue and profits. **Top Glove**, **Supermax** and **Kossan** remain our top picks.

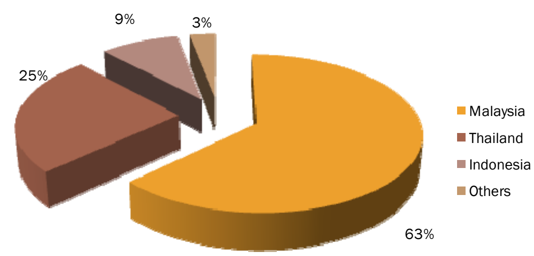
Stock	Price RM	Target RM	Mkt Cap RMm	Volume '000	PER (x)		FY0 ROE %	FY1 DY %	Rel. Performance %			P/NTA (x)	Rating
					FY1	FY2			1-mth	3-mth	12mth		
Adventa	3.28	5.37	470.7	1362.8	12.7	9.1	9.2	2.1	-5.6	-8.9	143.8	2.4	BUY
Hartalega	7.93	9.89	1921.5	259.1	13.4	12.4	33.1	1.5	3.2	6.6	86.7	8.2	BUY
Kossan	7.57	11.30	1210.2	535.7	10.2	9.4	18.7	2.0	-4.3	2.2	66.0	3.4	BUY
Supermax	5.85	9.11	1551.8	2731.2	7.9	7.7	23.3	1.5	-2.3	5.1	233.5	2.9	BUY
Top Glove	13.10	15.15	3975.9	992.6	15.1	14.3	20.5	1.4	0.4	6.1	71.4	5.2	BUY

To Note that Supermax target price adjusted from RM11.39 to RM9.11 after 1-for-4 bonus issue

BACKGROUND ON THE RUBBER GLOVE INDUSTRY

Global demand growing at 8%-10% p.a. We gather that annual global consumption of medical examination and surgical gloves totalled 135bn pieces in 2009, which is expected to grow further at 8%-10% a year. Going into 2011, global demand is expected to hit 155bn pieces p.a. whereby the H1N1 scare and continued alert on another outbreak as well as demand arising from the US' healthcare reform will spur growth over and above the normal 8%-10% yearly increase. And, out of this total, Malaysia is the largest contributor, supplying 63% of global demand. This huge market share is mainly due to: 1) the long learning curve required for new rubber glove manufacturers; 2) being located centrally in a latex producing region (from Malaysia itself, Thailand and Indonesia), and 3) having the support from the Government in providing natural gas, water and allowing the hiring of foreign labour.

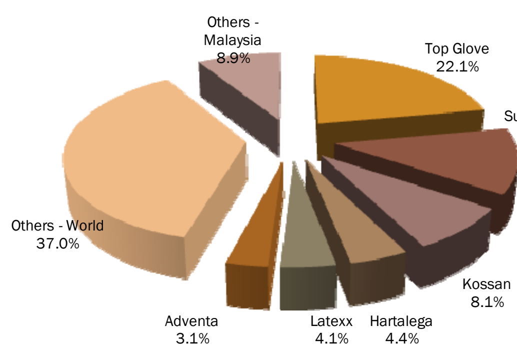
Figure 1: Major rubber glove producing countries



Source: Various companies, OSK

Top 6 major listed companies command 54% share of the global market. The remaining share is split between other global players at 37% and 8.9% share held by Malaysian manufacturers. These other Malaysian players are generally smaller sole-proprietor owned rubber glove manufacturers, but also includes WRP, which is quite big in size and was ranked the 5th largest exporter of all gloves in 2009. Although the examination glove market is monopolized by the Top 6 listed companies together with WRP, there is also a market for the smaller companies as they supply mainly to retailers as well as the non-medical industry.

Figure 2: Global market share of rubber glove manufacturers



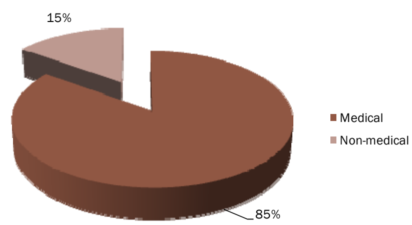
Source: Various companies, OSK

Industry divided into 3 key sectors. The rubber glove industry is divided into the upstream, midstream and downstream sectors. The upstream sector comprises owners of rubber plantations and latex concentration plants (for instance, Top Glove owns 2 latex plants in Thailand with a capacity of 78.5k tonnes p.a.). The midstream sector is the most common sector as it includes all rubber glove companies manufacturing both natural rubber and synthetic gloves. Finally, the downstream sector includes distributors, with the notable players being Supermax and Adventa while we understand that Top Glove, Kossan and Hartalega have healthcare MNCs as their distributors. We believe that having their own distribution units (such as Supermax) and relying on others to a certain degree (like Top Glove) does not vary in terms of customer and geographical reach as we gather that both of these companies sell to more than 750 customers in more than 150 countries.

Developed countries still favor powder-free natural rubber medical gloves. Firstly, the type of gloves which Malaysia is famous for producing is medical grade gloves, which make up about 85% of the country's total glove exports. In fact, more than 95% of all the top 6 listed rubber glove manufacturers' product mix comprises medical grade gloves; these companies also export 95% of their gloves. Next, we have 2 types of medical grade gloves – natural rubber and nitrile gloves. Based on 2009 statistics, natural rubber gloves are the preferred choice, commanding 74% of the pie while nitrile gloves make up the remaining 26%. This is because natural rubber gloves are cheaper and give a more natural feel compared to nitrile gloves. Also, the problem of protein content - once a major threat to the use of rubber gloves – has now become less of an issue given the technological improvements over the years. Finally, the third category of gloves' covers powder or powder-free gloves. This selection is usually based on personal preference although powder-free gloves are usually more expensive by USD2-USD3.00/1000 pieces.

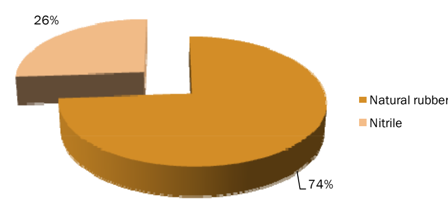
Developed countries consume the bulk of sales. We understand that more than 70% of medical grade gloves is exported to developed countries, with North America topping the list and taking up 38% of gloves from the market, followed by Europe with a 36% market share. Having said that, we believe the growth in this market is at a consistent 5%-8% while we think developing countries like China and India have potential of contributing growth of more than 20%.

Figure 3: Medical vs non-medical exports in 2009



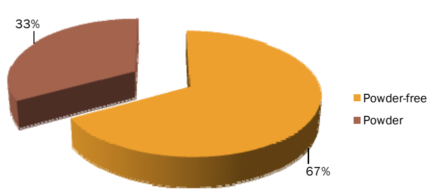
Source : MREPC, OSK

Figure 4: Natural rubber vs nitrile glove export in 2009



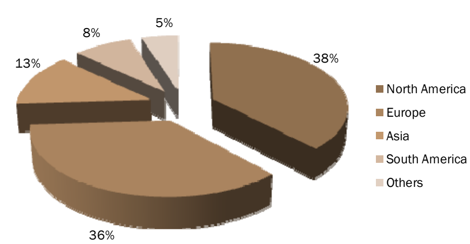
Source : MREPC, OSK

Figure 5: Powder vs powder-free gloves export in 2009



Source : MREPC, OSK

Figure 6: Export regions for Malaysian gloves in 2009



Source : MREPC, OSK

Figure 7: Top 5 exporters of all types of gloves in 2009

Company	Ranking
Top Glove	1
Supermax	2
Kossan	3
Hartalega	4
WRP	5

Source : MREPC, OSK

Figure 8: Top 5 exporter of natural rubber gloves in 2009

Company	Ranking
Top Glove	1
Supermax	2
WRP	3
Kossan	4
Ansell	5

Source : MREPC, OSK

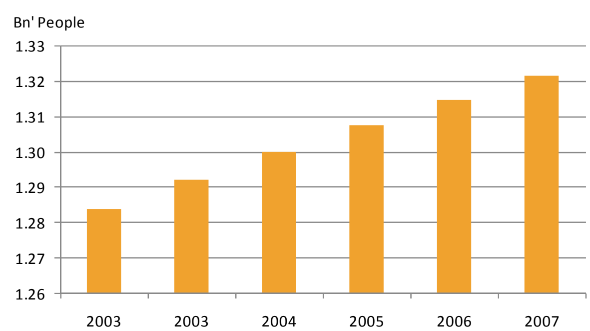
INDUSTRY DYNAMICS

High barriers to entry. The number of players in the global rubber glove industry has dwindled from more than 200 in 1990 to only 45 players in 2009. Over the years, there has been aggressive industry consolidation whereby the more efficient players had acquired the smaller and less efficient players to scale up their production capacity to achieve economies of scale to slash their production cost/piece. Although there are now only 45, the top 6 global players are Malaysian rubber glove manufacturers which dominate about 54% of the global market. Hence, it is not easy for new players to enter the industry as there would be a lot of catching given the steep learning curve of some 20 years, as well as the need to quickly have sufficient capacity and technological efficiency to mass produce and come up with an end product that can compete with those from the big boys.

Technology keeps on improving. Some of the notable technological improvements include: 1) higher production capacity/line (2010 production lines can produce 15.0k pieces/hour/line versus 2.5k pieces/hour/line in 1988; 2) heating systems (now we have natural gas or biomass versus 1988 when only natural gas or diesel were available), and 3) extensive automation (i.e. there is now automatic stripping of the rubber gloves from their molds compared with manual stripping in 1988). Going forward, we believe that further technological improvements will play an increasingly important role as the profitability of rubber glove manufacturers will depend on their ability to achieve economies of scale more rapidly and cost efficiently. We understand that some of the technology being studied include automatic packaging, especially when there is uncertainty in the supply of foreign labour, which may delay shipments of gloves. We gather that currently, the bulk of the 50k manual workers employed by the rubber glove industry is foreign.

Developing countries the next growth market. Braziil is a good example of a market where the surge in demand was mainly driven by 3 factors: 1) the Brazilian government tightening regulations by requiring each glove entering the country to carry the name of the manufacturer, which the smaller glove makers are unable to implement immediately; 2) the spread of the H1N1 pandemic, and 3) increased awareness of glove usage. This exceptionally strong demand has mainly benefited Top Glove and Supermax, which command about 40% and 30% respectively of the entire Brazilian market. Going forward, the developing countries would be a major growth driver for rubber glove manufacturers, led by China followed by India. We gather that the combined population of both regions is more than 2.5bn people, and hence the prospects for greater healthcare spending would be huge when the respective governments implement reforms or new health regulations. Also, we gather that China and India only spend some USD342 and USD109 per capita on average for healthcare compared to USD6,714 per capita in US.

Figure 9: China's population on a rising trend



Source: OSK

ISSUES CONFRONTING THE INDUSTRY

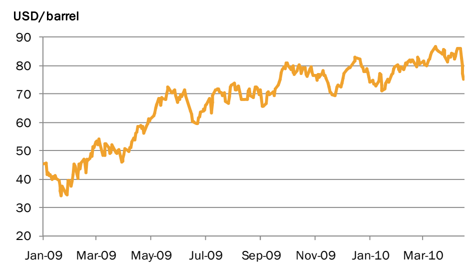
Latex price to gradually top out. Latex price had hit a high of RM7.72/kg in mid-April before falling back to close to RM7.00/kg recently. Of course, some of the major factors influencing this fall are: 1) the misperception that the general health of the global economy may affect the demand for latex. With the European nation facing financial problems coupled with the potential of a faster-than-expected slowdown in China's economy, there were concerns over the future demand for various commodities, including latex, which has dampened sentiment, and 2) drop in crude oil price, which has direct co-relation with the price of synthetic latex, which is seen as a direct substitute for natural rubber latex.

Other factors influencing latex price. These include: 1) the wintering season for rubber trees from Feb-May each year, during which latex price is generally higher since latex production from rubber trees is at its lowest; 2) the El-Nino effect, which cause latex production to fall in early 2010; 3) demand from the tire industry, which uses about 70% of global latex supply, and 4) prices of other commodities prices in general since latex is a tradable commodity. Going forward, we believe that latex price would not continue to remain at the all-time high as higher output is expected to come from the South-West Vietnam and South-East Cambodia regions.

Figure 10: Latex price trend

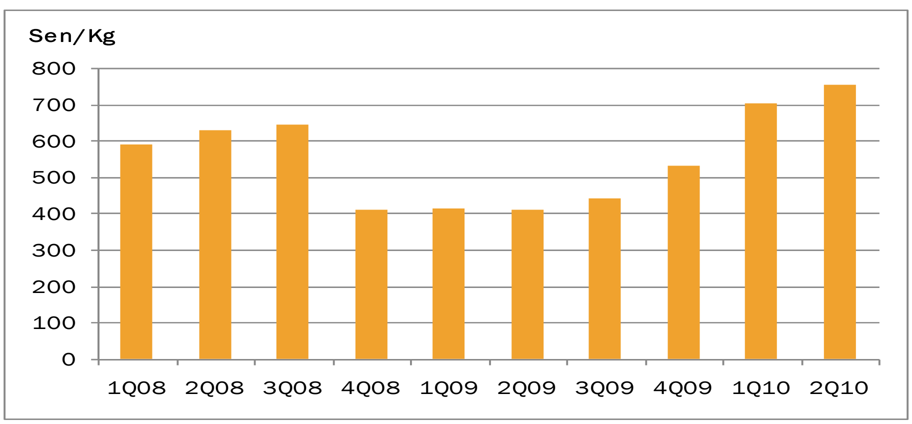
Source : OSK, Bloomberg

Figure 11: Crude oil price trend



Source : OSK, Bloomberg

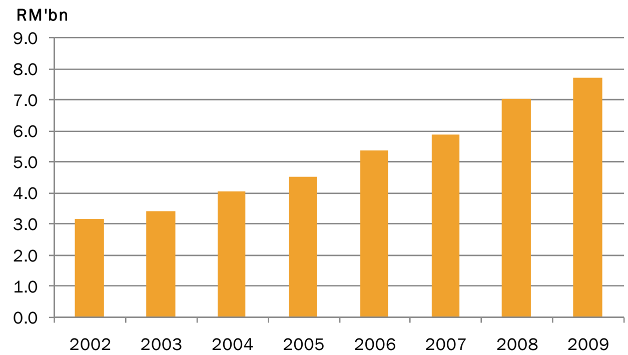
Figure 12: Average latex price/quarter



Source: OSK, Bloomberg

Natural gas issue likely to be resolved sooner or later. We understand that the lack of new natural gas supply is a major stumbling block to the growth of the rubber glove industry. Although some of the players may partly resolve this issue by scrapping some of their older or less efficient lines and replacing them with more new lines and resort to the use of biomass as an alternative to natural gas, we believe that all these measures can only increase their total capacity to a certain extent only as natural gas is still the preferred means of energy. Also, judging that the contribution of this industry to Malaysia's total export income, we believe it would be a matter of time before the government steps up natural gas supply to the industry.

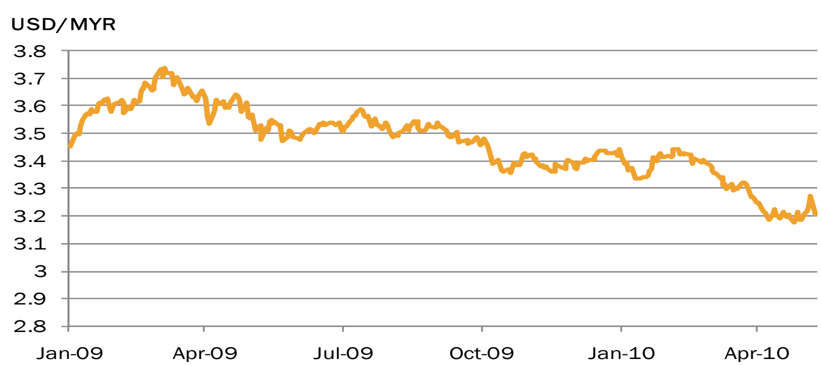
Figure 13: Malaysia's rubber glove exports



Source: MREPC

Minimal impact from weakening of USD against MYR. Although more than 90% of rubber gloves produced by the top Malaysian rubber glove manufacturers are exported in USD, we understand that the weakening of USD against MYR would still have minimal impact on their accounts. This is because glove manufacturers usually price their products at a higher or lower price range in anticipation of volatility in the exchange rate. Also, since latex comprises about 40%-50% of revenue and is priced in USD, this acts as a naturally hedge. For the balance 50%-60% of glove manufacturers' revenues in USD, the companies usually hedge some 50% of this, thus leaving about 25% of USD revenues unhedged.

Figure 14: USD/MYR



Source: OSK, Bloomberg

VALUATIONS AND RECOMMENDATIONS

Maintain Overweight on the sector. Our positive call is on the basis that there is: 1) persistently strong demand for examination rubber gloves from both the medical and hygiene markets; 2) increasing health and cleanliness awareness following the H1N1 pandemic; 3) high possibility of governments in developing countries implementing compulsory use of gloves, especially for the medical market; 4) a recovery in the global economy, especially the US and Europe regions, which will ultimately lead to higher living standards across the globe, and 5) local rubber glove manufacturers re-embarking on capacity expansion to boost revenue and profits.

Top Glove, Supermax and Kossan remain the top picks. We continue to like Top Glove's global market leadership and its good product mix (80% of which is natural rubber gloves), which are the basic and entry level examination rubber gloves targeting the developing countries. We believe that demand from these countries would be the growth driver of rubber glove companies going forward. Supermax, which is the world's second largest rubber glove producer, also has a product mix similar to Top Glove's, and is also targeting the developing countries. Finally, Kossan stands out as a balanced rubber glove manufacturer with a neutral mix of natural rubber and nitrile gloves targeting all markets. Do note that our Supermax target price has been adjusted from RM11.39 to RM9.11 to account for the 1 for 4 bonus issue.

Figure 15: Valuations of rubber glove companies

Stock	Target Price (RM)	FY11 PER Valuation (x)
Adventa	5.37	15
Hartalega	9.89	14
Kossan	11.30	14
Supermax	9.11	15
Top Glove	15.15	17

Source: OSK

OSK Research Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated (NR): Stock is not within regular research coverage

Published and printed by :-

OSK RESEARCH SDN. BHD. (206591-V)
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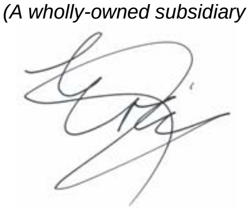

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