

Sector Flash Note

OVERWEIGHT (maintain)

Floor price of USD2.70/kg set for rubber

Tripartite setting a floor price

Last Friday, StarBiz reported that the three top rubber-producers namely Thailand, Malaysia and Indonesia (tripartite), have set a floor price of US\$2.70/kg (RM8.37/kg) for rubber. If this piece of news is true, this will be the third time the tripartite have come together to intervene in the rubber/latex price market. To recap, the tripartite had on 17 Aug 2012 agreed to cut exports by 300,000 tonnes to help support falling rubber prices. Also back in December 2008, the tripartite had come together for the very first time to cut as much as 915,000 tonnes of rubber exports when latex price fell to a low of RM3.46/kg.

Latex price has been on a roller coaster ride of late

Latex price has fallen by -33% from its March 2012 peak of RM10.90/kg to RM5.27/kg in 16 Aug 2012 before recovering to RM6.40/kg following the tripartite's intervention in 17 Aug 2012. All else being equal, low latex price is positive to natural rubber gloves manufacturers as latex cost accounts for around 60% of the production costs. Note that the gloves manufacturers are buying the SMR2 liquid latex, containing a mix combination of rubber and water with a ratio of 60:40. That said, the actual minimum cost of rubber that the glove manufacturers are buying is RM5.27/kg.

Maintaining our RM7.20/kg latex price assumption for FY12-14

In our earnings model, we have assumed an average latex cost of RM7.36/kg for CY12, RM7.08/kg for CY13 and RM7.23/kg for CY14. For a pure natural rubber glove producer, every RM1/kg rise in latex price will raise the cost of production by 6% and thereby dampening net earnings by around 13%.

Rubber prices unlikely to scale sky high with China's weak demand

Given the sluggish auto demand in China, a major source of demand for latex, we believe latex price will unlikely to rebound significantly despite the tripartite's interventions. That said, stabilizing in latex price is positive to the rubber glove industry as it helps to provide pricing visibility to customers.

Maintain Overweight on the sector

Taking into account the continued healthy demand growth for rubber gloves and amid better health awareness in the emerging markets and better operating efficiency due to automation of the glove players, we are maintaining our OVERWEIGHT call for the sector. Key risk to our view is a resurgence in latex price, should demand for rubber from China stage a strong recovery.

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Figure 1: Valuation matrix

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Core PE (x)		EPS growth (%)		EV/EBITDA (x)	P/B (x)	ROE (%)		Net Div Yield (%)	
					CY12	CY13	CY12	CY13			FY12	FY13	FY12	FY13
Kossan	ADD	3.25	3.40	1039.1	10.5	9.0	10.1	16.8	5.9	1.8	18.5	18.7	2.2	2.5
Top Glove	BUY	5.29	6.20	3274.2	16.2	14.0	45.4	16.0	9.8	2.7	15.8	17.0	2.5	2.8
Supermax	BUY	2.02	2.55	1373.9	10.3	9.1	23.6	13.0	8.3	1.3	14.7	13.5	3.0	3.5
Hartalega	REDUCE	4.50	4.10	3289.3	15.8	14.3	3.2	10.2	10.4	4.6	31.3	30.3	2.9	2.9
Adventa**	NR	1.83	na	279.6	13.7	11.3	201.0	21.5	9.0	1.4	11.2	16.0	2.7	4.0
Latexx**	NR	1.61	na	358.8	8.3	7.0	-2.3	18.8	4.4	1.3	14.1	14.8	2.4	2.9
Simple average					12.5	10.8	46.8	16.1	8.0	2.2	17.6	18.4	2.6	3.1

**based on consensus estimates

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Figure 2: Latex price trend



Source: Bloomberg

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +15% over a 12-month period
TRADING BUY (TR BUY)	Total return is expected to exceed +15% over a 3-month period due to short-term positive development, but fundamentals are not strong enough to warrant a Buy call. This is to cater to investors who are willing to take on higher risks
ADD	Total return is expected to be between 0% to +15% over a 12-month period
REDUCE	Total return is expected to be between 0% to -15% over a 12-month period
TRADING SELL (TR SELL)	Total return is expected to exceed -15% over a 3-month period due to short-term negative development, but fundamentals are strong enough to avoid a Sell call. This is to cater to investors who are willing to take on higher risks
SELL	Total return is expected to be below -15% over a 12-month period
NOT RATED	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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