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Sector News Flash

Rubber Gloves

Latex Price Collapses

THE BUZZ

Last Friday, latex price quoted by the Malaysian Rubber Board dropped by a significant RM0.45/kg, or 6.4%, in one day to RM6.56/kg. This means that latex price has plunged by RM1.02/kg, or 13.5% in a week, from the previous Friday's (4 Nov 2011) price of RM7.58/kg.

OUR TAKE

Sharp drop in a very short period of time. The most recent sharp drop was in mid-February 2011 to mid-March 2011, during which latex price retraced sharply by RM2.33/kg from its high of RM10.90/kg to RM8.56/kg in a matter of 3 weeks. However, it rebounded to its all-time high of RM10.93/kg in early-April 2011 although it failed to sustain that level. From then on, latex price entered into a downtrend, with prices dropping gradually until recently, when we witnessed the very steep drop of RM1.02/kg last week.

Is the drop sustainable? We believe the longer term downtrend is likely to be sustained, but probably not at the same intensity as the recent retracement. In our opinion, the drop has been too sharp, and based on the recent trend of sharp historical retracement, latex price tends to rebound strongly within days. Nevertheless, we maintain our longer term view that it may continue to fall back, probably to the RM6.00-RM7.00/kg level because: (i) it has not retraced sufficiently since 3 years ago, starting from 2009, and the price usually peaks in 1H every year when the wintering of rubber trees sets in, and falls back in 2H when supply catches up, (ii) the strong demand growth is no longer there as rubber glove manufacturers are gradually shifting their product mix to nitrile gloves, and given the lack of a pandemic and (iii) the automotive sector is experiencing a setback in demand amid the global economic slowdown; and the operations of many auto manufacturers are being adversely affected by the recent floods in Thailand. Hence, we do not think latex price will return to its all-time high of RM10.93/kg.

Top Glove and Supermax still the main beneficiaries. This is mainly because of their product mix comprising 75% natural rubber gloves, which is the highest among their peers. Hence, both companies will benefit the most following the drop in the price of natural rubber latex. With latex price at about RM9.00/kg, which we understand made up about 65%-67% of their total cost, these companies were only previously passing on 70% of their higher latex cost to their customers. Hence, we see the drop in latex price benefit the two companies on two fronts: i) the incremental cost being absorbed by them, if any (which is the balance 30%), would be much lower now compared to before, and ii) there will be boost in sales volume leading to higher earnings in the immediate term (4QCY11) as customers may stock up on the belief that the drop is too steep and is unsustainable.

Maintain Overweight. Our top pick remains **Supermax (BUY, FV: RM5.50)**. We continue to like the company's attractive valuation (trading at single digit PER valuation of 9x FY2 EPS) versus **Top Glove (NEUTRAL, FV:RM4.00)**, which is trading at 17x FY2 EPS. Also, we like the fact that the two companies operate in an industry that is resilient against downturns.

OVERWEIGHT ↔

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

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