

## THE RUBBER INDUSTRY

Malaysia is the world's fifth largest producer of natural rubber after Thailand, Indonesia, Vietnam and China. Natural latex from rubber while synthetic rubber is a derivative from petrochemical.

The key property of natural rubber is low heat built up. It is used in gloves and also for production of tyres. However, synthetic rubber though it is not as good a heat resistance than natural rubber, it is easier to be modified into different forms.

## DOWN STREAM

In this article, I researched on listed companies in Malaysia involved in downstream rubber sector could be categorized into four main sectors. For analysis, there are ten such companies.

1. Rubber glove
2. Tyre retreading
3. Rubber hose for industrial use
4. Condom

LISTED COMPANIES	Annual Revenue, RM Millions	Exported %	Annual Production of Gloves, Billion Pieces	Profit / (Loss) After Tax, RM Millions	Net Assets, RM Millions	Market Capitalization, as at 24 November 2017, RM Millions
<b>Rubber Gloves</b>						
Top Glove Corporation Bhd	3,409	Ex-Asia makes up more than 80%	52	329	2,012	8,478
Supermax Corporation Bhd	1,170	Asia makes up 95%	23	67	1,088	1,422
Kossan Rubber Industries Bhd	1,918	95%	22	167	1,174	5,084
Hartalega Holdings Bhd	2,169	Ex-Asia makes up more than 90%	23	283	1,862	15,437
Comfort Glove Bhd	355	89%	4	26	225	587
Rubberex Corporation (M) Bhd	341	69%	1	21	274	168
<b>Tyre retreading and others</b>						
Eversafe Rubber Bhd	75	57%		6	48	87
Goodway Integrated Industries Bhd	142	52%		(46)	41	22
<b>Condoms</b>						
Karex Bhd	361	Ex-Asia makes up more than 75%		28	498	1,503
<b>Rubber hose (industrial use)</b>						
Wellcall Holdings Bhd	148	91%		31	101	702

Tabulated by AER

Four companies (Top Glove, Supermax, Kossan Rubber and Hartalega) accounted for approximately an annual output of 120 billion units of gloves, making up approximately 57% of the world consumption in 2016.

## COMPANIES IN DOWNSTREAM RUBBER PRODUCTS IN MALAYSIA – CONTRIBUTES MORE THAN RM 10 BILLION IN ANNUAL REVENUE

LISTED COMPANIES	Closing Price as at 24 November 2017, RM	TWR from 3 January 2017, %	Trading P/E	Trading P/B	Fair P/B	Net Margin, %	Net Cash / (Borrowings) RM millions	Altman Z-Score	Average annual dividend yield, past three years, %
<b>Potentially, Undervalued</b>									
Top Glove Corporation Bhd	6.75	33%	26	4.3	4.9	10%	(138)	6.9	3%
Comfort Glove Bhd	1.05	73%	16	2.6	3.5	10%	1	7.7	0%
Rubberex Corporation (M) Bhd	0.67	-13%	8	0.6	0.9	6%	(49)	2.5	4%
<b>Potentially, Overvalued</b>									
Hartalega Holdings Bhd	9.35	113%	43	8.4	5.5	17%	(100)	13.7	2%
Karex Bhd	1.50	-39%	54	3.1	1.1	8%	64	12.5	1%
Goodway Integrated Industries Bhd	0.20	-73%	Loss	0.5	-	-32.6%	(92)	(0.1)	0%
<b>Fairly Valued</b>									
Supermax Corporation Bhd	2.09	0%	18	1.3	1.4	7%	(262)	2.7	2%
Kossan Rubber Industries Bhd	7.95	26%	28	4.4	4.6	10%	(154)	7.4	2%
Eversafe Rubber Bhd	0.36	9%	12	1.6	1.5	8%	(5)	NA	0%
Wellcall Holdings Bhd	1.41	24%	20	6.8	7.0	23%	24	18.4	4%

Tabulated by AER

### 1. Rubber Glove Sector

Rubber glove sector is a recession-proof (i.e. non-cyclical) consumed mainly in healthcare. The rubber gloves produced by all the listed companies are mostly exported and hence benefitted from the exchange currency returns in recent years. There are six listed companies involved in production of gloves.

#### TOP GLOVE CORPORATION BHD – MARKET LEADER IN TERMS OF ANNUAL OUTPUT

Top Glove being the market leader in terms of number production units amongst all the listed companies in the glove production. Presently, it has a P/E of 26 times and P/B of 4.3 times.

On 24 November 2017, Top Glove announced that it proposes to acquire Aspion Group for a purchase consideration between RM 1.3 billion to RM 1.4 billion, to be paid by at least 90% in cash consideration. This valuation is arrived based on an P/E multiple of between 16 times to 18 times based on an aggregate projected profit after tax of RM 80 million of Aspion Group for FY 2018.

From valuation perspective it is positive to its enterprise value. Due to the debt is increased at a P/E of between 16 times to 18 times while the equity is increased by Top Glove's P/E which is more than 20 times.

From public announcements made available, it seemed that the proposed acquisition shall be financed by debt. If so this will likely to increase the gearing level of the company in future.

Aspion Group is wholly owned by Adventa Group Pte Ltd, whose major shareholders are Low Chin Guan and Singapore based private equity fund, Southern Capital Ltd.

## RUBBEREX CORPORATION (M) BHD

Amongst all the listed companies in rubber glove, Rubberex business is more domestic focussed. It is also has the smallest annual production capacity at approximately 1 billion pieces. It is a bit under-valued at this moment compared with its peers.

Possible reason may be due to a common phenomenon that if the sector has too many bigger companies, the smaller company's activity gets lesser attention and investor's interest by general investors. This is sometimes referred to as a "small fish in a big pond". Generally, these type of companies will be getting attention when there is any corporate exercises.

## HARTALEGA HOLDINGS BHD – HIGHEST MARKET CAPITALIZATION AT RM 15 BILLION

It has the largest market capitalization of approximately RM 15.4 billion amongst all the listed companies in the glove production. This is followed by Top Glove at RM 8.5 billion. From the perspective of relative comparison, Hartalega seems to be overvalued with a current P/E of 43 times and P/B of 8.4 times.

Hartalega is reported to be the world's largest nitrile (i.e. synthetic) glove rubber producer.

## 2. Tyre Retreading

Tyre-retreading is basically stripping away the remaining tread and sidewall of used tyre and then blend with natural and / or synthetic rubber and other compounds to produce retreaded tyres.

During economic slowdowns, demand for retreaded tyres may increase as it is more economically compared to replacing with brand new tyre.

## EVERSAFE RUBBER BHD

It was listed in the ACE market on April 2017. Issuing price was RM 0.36 per share.

## GOODWAY INTEGRATED INDUSTRIES BHD

It has a negative Altman Z-Score which indicates that the company needs to address its liquidity risk.

## 3. Rubber Hose

### WELLCARE HOLDINGS BHD

91% of Wellcall Group's revenue were exported to over 70 countries while the remainder was from local market. For the past five years, the annual net margin registered is above 25%. The annual ROE is also above 30%. It is currently trading at 6.8 times its book value, close to its fair value. Wellcall is the only company that in the rubber hose industrial use that is listed.

It has a high Altman Z-Score at 18.4 a company with very negligible liquidity risk suitable for investors with longer investment horizon at suitable price.

## 4. Condom

### KAREX BHD

Karex manufactures condoms for customers as an OEM and also recently manufactured under its own brand. Karex also acquired a distributor company in UK, i.e. Pasante, as a channel to market its product in Europe. Currently it seems to be overvalued, trading at high P/E of 54 times and P/B at 3.1 times;

### KEY EXTERNAL FACTORS AFFECTING THE RUBBER INDUSTRY

Manufacturers that are dependent on latex as inputs will be dependent on the cost of latex as its key inputs. As for manufacturers that are dependent on synthetic rubber, their cost structure has some positive relationship with price of oil, as synthetic rubber is made from derivative of oil products.

Producers that are exporting their business may see performance of their business is affected in a negative manner due to the recent strengthening of RM against USD.

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