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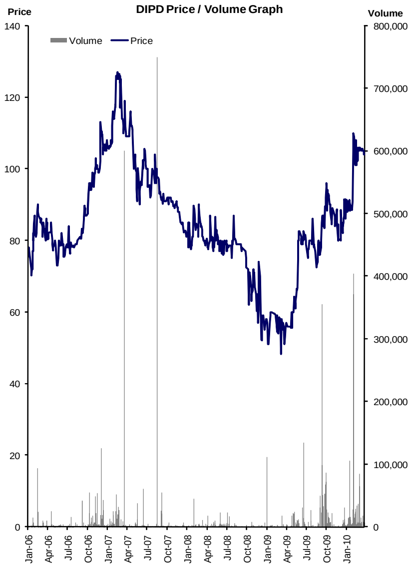
Dipped Products PLC (DIPD)

Rs 105.00 **BUY**

DIPD			
Reuters Code			DIPD.CM
Bloomberg Code			DIPD.SL
Share Price LKR			105.00
Issued Share Capital (Shares)			59,861,512
12 mth High/Low (Rs.)			115.00 / 52.50
Average Daily Volume			17,043
Market Capitalisation Rs. mn			6,285,458,760
Price Performance (%)	1 mth	6 mth	12mth
ASPI	(1.12)	28.12	128.94
DIPD.N	(1.42)	16.20	96.20

Fiscal Year	Earnings (Rs.m)	EPS (Rs.)	EPS Growth (%)	PER (x)	P/BV (x)	ROE (%)
2008	371.12	6.20	(33.53)	16.94	2.24	13.21
2009	362.87	6.06	(2.16)	17.32	2.04	11.78
2010E	444.53	7.43	22.50	14.14	1.91	13.49
2011E	587.71	9.82	32.21	10.69	1.72	16.08
2012E	737.95	12.33	25.56	8.52	1.51	17.72
2013E	883.15	14.75	19.68	7.12	1.30	18.32



The global downturn impacted the rubber gloves industry in 2009, resulting in lower volumes but a better sales mix as well as a turnaround in the long suffering Thailand facility improved DIPD earnings for FY2010.

Dipped Products posted revenue of Rs.8.3bn for the nine months of FY10, a 10% dip from the comparative period. Nine month earnings were up 49.7% to Rs.275m while 3Q earnings of Rs.163m rose by 108.5% YoY.

With an approximate 5% share of the global market, Dipped Products Group is one of the top 5 non-medical rubber glove manufacturers in the world. The company has a wide product range combining materials like natural rubber, synthetics and palmrite. The company owns 71% of the listed plantation Kelani Valley and is an approximately 41% owned associate of Hayleys.

Global demand for rubber gloves should resume over the next few years as economies improve. Greater awareness of health standards and stronger regulatory standards on occupational safety will also drive volume growth. Dipped Products has planned capacity expansions in both volumes as well as product range. Management is on record as stating that there is a very real possibility that the company could double or triple in size over the next few years.

Kelani Valley Plantations PLC

Their 71% owned subsidiary Kelani Valley Plantations manages 27 estates, over 13,000 hectares in extent, divided almost equally into tea and rubber. Last year's 40% wage hike unexpectedly increased operational costs which can be compensated with improved productivity, reasonable price levels and optimum harvests.

Tea producers are enjoying record high prices because of a continuing global shortage created by a crop shortfall last year and growing demand in major consuming countries. Rubber has also fetched higher prices. A far more extreme supply-demand mismatch is present in rubber with consumption in India, China and emerging markets zooming in recent times due to heavy industrial demand. The improving prices have boosted profitability with Kelani Valley's December quarter. A significant share of Dipped Product's rubber requirements are sourced from Kelani Valley.

Global market for gloves

Strong growth in the glove industry has not abated due to the global recession with aggressive expansion in recent years due to an increase in demand for nitrile and medical gloves fuelled by rising healthcare standards in China and India along with concerns following repeated outbreaks of contagious diseases such as bird flu and SARS. Estimates of global demand for gloves vary widely with some estimates at 140-150bn pieces and is expected to grow by 8-10% with medical glove volume growth estimated at 10-12% and non-medical at 6-7%. Demand for rubber gloves remains robust, with global consumption of 140b pieces expected to grow by 8-10% p.a. Revenuewise this market is estimated at US$90bn with US$25bn of this being non-medical. Glove demand growth in developing countries will outpace that of the rest of the world. Penetration is increasing in new markets like Latin America as well as China, India and Eastern Europe. Growth in these markets could be as high as 20%.

Comparable global peers

Dipped Products is one of many companies benefiting from a secular rise in earnings across all rubber glove manufacturers. The main comparable firms can be found in Malaysia which is the largest glove producing nation.

Top Glove has a 23% global market share (2010 world demand is estimated at 150bn pieces. Top Glove earnings also increased by 53.6% for the Aug FY2009 to RM169.1m. The company posted a 90.9% jump in net profit to RM65.2m in its first quarter ended Nov 30, 2009.

Supermax's FY2009 Dec earnings were up 176.2% to RM 129.8m despite flat revenue, due to better margins. The company is planning to expand capacity by 50% by 2011.

Prospects

Dipped Products has planned capacity expansions over the next few years which should improve both volumes and product range. The initial plans for Thailand capacity are now planned to be carried through with a 50% expansion due by the next financial year with more to come. However larger volumes are not necessarily tied to better earnings with margins and sales mix playing a more important part. The company is confident that barring wild swings in rubber prices that this sales mix strategy will help them maintain margins.

Dipped Products stepping into the larger medical gloves segment should give the company a wider range of products and a different set of customers which should give it diversification. While medical gloves are broadly lower margin products than their conventional business, some segments such as surgical gloves are higher value added better margin than products like domestic usage gloves. Medical gloves is also more resistant to broad economic downturns in addition to being a larger market.

3QFY10 Results

A 10% revenue drop has not affected Dipped Product's dramatic upswing in earnings with the company's better performance in the core hand protection business more than offsetting minimal plantations earnings. The 3Q YoY improvement of 108.5% for earnings to equity however needs to be seen in perspective with the 234% QoQ sequential growth. We expect the final quarter to be substantially higher thanks to the recovery in tea prices boosting the plantations subsidiary.

Overall GP margins have stayed flat YoY to 20.4% from 20.3% previously. PBT has also improved about 66.7% from an year ago with associate Mabroc also making a marginal profit from their loss in the comparative quarter. Finance costs have also improved this quarter declining 60.5% to Rs.30m

Segmental earnings for hand protection have shown a significant improvement of 67.1% from last year on only marginally higher revenue. Consequently this means segmental margin has improved to 10.3% from 6.3%. As per management Dipped Products Thailand had contributed pre-tax earnings of Rs.82m for the nine months and increased turnover by 20 per cent to Rs 1.1bn. Ico-Guanti, the group's Italian marketing company had also recorded cumulative pre-tax earnings of Rs.171m.

Valuations

Although the recovery in the higher value added segment was sluggish in FY10, demand for rubber gloves is slowly improving amidst the dissipating global recession. We expect the company to make a 24.9% earnings CAGR over the next four years thanks to their expansion efforts as well as more aggressive management. At Rs.105 Dipped Product's PER is 10.7x FY11E earnings with the expected FY13 multiple coming down to 7.1x. With the broader market expected to trade in the 12-15x range over the FY11 earnings season we feel the company is trading at an unwarranted discount to market. **BUY**.

Income Statement	**2008**	**2009**	**2010E**	**2011E**	**2012E**	**2013E**
For the year ending 31st March	**Rs. mn**	**Rs. mn**	**Rs. mn**	**Rs. mn**	**Rs. mn**	**Rs. mn**
Revenue	11,153	11,896	11,420	14,218	15,924	18,074
Cost of Services	(8,974)	(9,503)	(8,908)	(10,948)	(12,103)	(13,655)
Gross profit	**2,179**	**2,393**	**2,512**	**3,270**	**3,822**	**4,419**
Other operating income	13	15	8	8	8	8
Admin expenses	(986)	(1,045)	(1,187)	(1,394)	(1,617)	(1,876)
Distribution expenses	(393)	(408)	(457)	(524)	(587)	(657)
Other expenses	(11)	(5)	(12)	(12)	(12)	(12)
Operating profit	**802**	**949**	**865**	**1,348**	**1,614**	**1,882**
Net finance cost	(223)	(333)	(268)	(188)	(131)	(92)
Associate	37	(0)	81	64	55	50
PBT	**616**	**616**	**678**	**1,224**	**1,537**	**1,840**
Tax	(101)	(114)	(203)	(367)	(461)	(552)
Minority interest	(144)	(140)	(30)	(269)	(338)	(405)
Net earnings	**371**	**363**	**445**	**588**	**738**	**883**

Balance Sheet	**2008**	**2009**	**2010E**	**2011E**	**2012E**	**2013E**
As at 31st March	**Rs. mn**	**Rs. mn**	**Rs. mn**	**Rs. mn**	**Rs. mn**	**Rs. mn**
Fixed Assets						
PP&E	4,403	4,827	5,068	5,271	5,482	5,701
Invesment in associate	99	90	171	235	290	340
Long term investments	197	197	197	197	197	197
Intangible assets	16	16	16	16	16	16
Deferred tax asset	12	22	22	22	22	22
	4,726	**5,152**	**5,474**	**5,741**	**6,006**	**6,276**
Current Assets						
Inventories	1,900	1,926	1,941	2,417	2,707	3,073
Trade and other receivables	2,858	3,035	2,912	3,626	4,061	4,609
Amount due from associate		6	6	6	6	6
Cash and equivalents	113	308	237	69	436	731
	4,872	**5,275**	**5,097**	**6,117**	**7,209**	**8,418**
Current Liabilities						
Trade and other payables	1,395	1,275	1,099	1,706	1,911	2,169
Amount due to Hayleys	12	8	8	8	8	8
Income tax payable	2	8	8	8	8	8
Borrowings	2,153	2,717	2,890	3,012	3,012	3,285
	3,562	**4,009**	**4,006**	**4,735**	**4,940**	**5,471**
Non current Liabilities						
Borrowings	1,360	1,219	1,120	1,049	1,354	1,241
Deferred tax liabilities	133	140	140	140	140	140
Retirement benefit obligation	742	811	811	811	811	811
Other	280	382	382	382	382	382
	2,515	**2,552**	**2,453**	**2,382**	**2,687**	**2,574**
Net Assets	**3,521**	**3,865**	**4,112**	**4,741**	**5,589**	**6,649**
Stated Capital	599	599	599	599	599	599
Reserves	2,212	2,481	2,697	3,057	3,567	4,222
Shareholder's Funds	2,810	3,079	3,296	3,655	4,165	4,820
Minority interest	711	786	816	1,085	1,424	1,828
Total Equity	**3,521**	**3,865**	**4,112**	**4,741**	**5,589**	**6,649**

Cash flow statement For the year ending 31st March	2008 Rs. mn	2009 Rs. mn	2010E Rs. mn	2011E Rs. mn	2012E Rs. mn	2013E Rs. mn
PBT	**616**	**616**	**678**	**1,224**	**1,537**	**1,840**
Depreciation / Amortization	363	384	340	278	292	306
Net finance costs	308	305	(116)	188	131	92
Associate	(37)	0	(81)	(64)	(55)	(50)
Other	274	122				
Change in working capital	(382)	(330)	(69)	(582)	(725)	(914)
Cash from Operations	**1,141**	**1,097**	**752**	**1,044**	**1,180**	**1,275**
Finance costs paid	(308)	(305)	116	(188)	(131)	(92)
Income tax paid	(170)	(141)	(203)	(367)	(461)	(552)
Other	(53)	(62)				
Net Cash from Operations	**611**	**590**	**665**	**489**	**588**	**631**
Net PPE	(671)	(795)	(581)	(481)	(503)	(526)
Net Investments	(2)					
Other	41	89				
Net Cash from Investing	**(632)**	**(706)**	**(581)**	**(481)**	**(503)**	**(526)**
Net Borrowings	(215)	(92)	74	51	510	418
Dividends paid	(228)	(101)	(228)	(228)	(228)	(228)
Other						
Net Cash from Financing	**(442)**	**(193)**	**(154)**	**(177)**	**282**	**190**
Net increase in Cash	**(464)**	**(309)**	**(71)**	**(169)**	**367**	**295**