# GLOVES

## *Maintain* NEUTRAL

***Managing the disruption in the global supply chain***

### KEY INVESTMENT HIGHLIGHTS

- **Malaysian' glove manufactures stand to benefits from the recent US tariff imposition on China made glove, leading to higher demand of medical gloves**
- **Export to Europe under threat as China's glove manufacturers is expected to reroute its glove export to Europe in view of the trade sanction**
- **Local glove manufacturers would need to price their products competitively to defend their market share in Europe**
- **Declining rubber latex price as well as on-going effort to install more efficient production lines is expected to further reduce production cost**
- **Maintain NEUTRAL on the sector**

**A sequential weaker quarter.** From the recently concluded 2QCY19 earnings season, sequential earnings growth was weaker for **Top Glove Corporation Bhd (Neutral, TP: RM4.70)**, **Kossan Rubber Industries Bhd (BUY, TP: RM4.64)** and **Supermax Corporation Bhd (BUY, TP: RM2.07)**. This was due to the abrupt upward movement in the rubber latex price by about +23.0%qoq to RM5.00/kg. Consequently, profit margin was eroded as natural rubber glove was of a sizeable percentage of total production volume. In addition, profitability was adversely impacted due to the time lag of two to three months before the higher cost can be passed to consumers causing a mismatch between raw material costs and selling price. However, we observed that rubber latex price has eased by -12.0%qoq to about RM4.40/kg. Hence, we expect a lower cost of production going forward.

**Expecting increase in export to the US.** Effective from 1st September 2019, the US government had imposed a 15.0% tariff on medical gloves made in China. This is in addition to the 25.0% tariff imposed previously on industrial glove made in China. As a result, US importers are shifting the source of supply for medical and industrial glove from China to glove manufacturers in the ASEAN region specifically Malaysia, Thailand, Indonesia and Vietnam. The imposition of tariff on medical glove from China is expected to have a positive impact to the top four local glove manufacturers in the near term given their focus on producing medical glove (>90.0% of production volume) and established presence in the US market (>30.0% of total revenue). Note that the US imported about 10.0% of its glove from China.

**Improving demand and supply dynamics.** We gathered that the uncertainties on tariff imposition resulted in glove importers to hold back on their purchasing decision previously. Due to this, total export of natural and nitrile glove decreased by -4.4%yoy to 38.7b pairs in the 1HCY19. Nonetheless, we expect a better 2HCY19 as the demand normalise. Note also that the total annual production capacity of the top four manufactures is expected to increase to about 160.0b pieces by the end of CY19 (+9.0%yoy). This is after taking into account the reschedule in capacity expansion plan of about 6.0b of capacity in CY19. Hence, the additional capacity will be matched by an elevated demand from the US at least until the next US presidential election in Nov 2020.

**COMPANY IN FOCUS**

**Kossan Rubber Industries Bhd**

**Maintain BUY |** Unchanged Target price: RM4.64

Price @ 10th September 2019: RM4.27

- Temporary decline in 2QFY19 production volume due to the scheduled upgrading works
- Two new high tech plants will add additional 5.5b pieces of new production capacity (+20.8%)
- Downward pressure in ASP will be partially alleviated by the improvement in operating efficiency

**Share price chart**

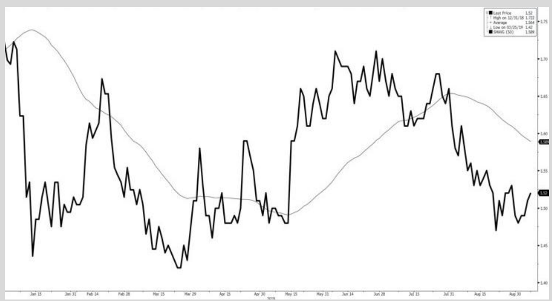
**Supermax Corporation Bhd**

**Maintain BUY |** Unchanged Target price: RM2.07

Price @ 10th September 2019: RM1.52

- Temporary blip in 4QFY19 earnings due to the sharp rise in rubber latex price
- However, we observe that the rubber latex price has moderated in recent months
- Currently undergoing replacement of old production facilities to further improve operating efficiency

**Share price chart**



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**However, downward pressure on average selling price (ASP) to persist.** As at 2QCY19, we observed a marginal improvement in ASP (between +1.0%qoq to +2.0%qoq). However, in reaction to the aforementioned trade sanction, China's glove manufacturers will reroute its export to Europe. This will result in an intense competition given that Europe is another big market for local glove players which historically constitutes between 20% and 40% of total revenue. To maintain the demand and supply equilibrium, we expect that ASP will remain subdued. In such environment, we do not think that glove players can fully pass on any upward variation in cost of production.

**Working towards greater operating efficiency.** Aside from capacity expansion contributed by new plants, glove manufacturers are also focusing on revamp and upgrading works by decommissioning old production lines that are inefficient and replace these with new highly efficient production lines. In 2QCY19, Kossan carried out scheduled revamp and upgrading works across the group's plants for approximately five days. Meanwhile, Supermax had previously replaced a part of the old lines at Kamunting Raya plant with highly efficient double former lines which added 1.35b pieces of capacity to the group. Going forward, the group has allocated about RM325.0m for its upgrading, rebuilding and replacement of old lines which will add more than 3.0b to its total capacity by the end of CY21. Despite **Hartalega Holdings Bhd (Neutral, TP: RM4.77)** still has a superior operating efficiency in the market (with line speed of 45.0k pieces/hour vs 42.8k pieces/hour in the market), we are positive on Kossan and Supermax efforts to catch up with their bigger peer.

**Maintain NEUTRAL.** We expect the local glove manufacturer to incur lower production cost, especially in 2HFY19 mainly due to the easing price of natural rubber latex. This would provide more avenues for the glove manufacturers to maintain their product pricing competitiveness, especially for the Europe market since there could be threats from their China peers. Meanwhile, we view that the worsening trade sanction between China and US would further boost the export of glove products, i.e. medical gloves and industrial gloves, to the US market. Coupled with the glove manufacturers' efforts to regulate their respective expansion plan, we expect the demand and supply dynamics to improve further. On a flip side, we believe that the ASP to remain subdued given the heightening competition, especially from the Europe region. Taking all factors into consideration, we are maintaining our **NEUTRAL** stance on the glove sector.

## PEER COMPARISON TABLE

| Stock | FYE | Rec' | Price @ 10th Sept 19 | Target Price (RM) | EPS (sen) | | PER (x) | | Net DPS (sen) | | Net Divd Yield (%) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | FY19E | FY20F | FY19E | FY20F | FY19E | FY20F | FY19E | FY20F |
| Kossan | Dec | BUY | 4.27 | 4.64 | 18.8 | 21.1 | 22.7 | 20.2 | 7.0 | 8.0 | 1.6 | 1.9 |
| Supermax | Jun | BUY | 1.52 | 2.07 | 11.8 | 13.8 | 12.9 | 11.0 | 5.5 | 6.5 | 3.6 | 4.3 |
| Top Glove | Aug | NEUTRAL | 4.72 | 4.70 | 15.4 | 18.8 | 30.6 | 25.1 | 8.5 | 9.4 | 1.8 | 2.0 |
| Hartalega | Mar | NEUTRAL | 5.31 | 4.77 | 12.7 | 15.4 | 41.8 | 34.5 | 6.0 | 7.3 | 1.1 | 1.4 |

*Source: Company MIDFR*

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| MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS | |
|---|---|
| **STOCK RECOMMENDATIONS** | |
| **BUY** | Total return is expected to be >10% over the next 12 months. |
| **TRADING BUY** | Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow. |
| **NEUTRAL** | Total return is expected to be between -10% and +10% over the next 12 months. |
| **SELL** | Total return is expected to be <10% over the next 12 months. |
| **TRADING SELL** | Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow. |
| **SECTOR RECOMMENDATIONS** | |
| **POSITIVE** | The sector is expected to outperform the overall market over the next 12 months. |
| **NEUTRAL** | The sector is to perform in line with the overall market over the next 12 months. |
| **NEGATIVE** | The sector is expected to underperform the overall market over the next 12 months. |