

14 September 2017 | Sector Update

Gloves

Maintain NEUTRAL

Sector earnings momentum to remain stable

INVESTMENT HIGHLIGHTS

- **Sector earnings momentum to remain stable**
- **Earnings continue to be demand driven**
- **Raw materials price on an increasing trend**
- **Stable USD will be more beneficial to gloves manufacturers in the longer term**
- **Maintain NEUTRAL on the sector**

Sector earnings momentum to remain stable. In the recently concluded earnings season, most of the gloves manufacturers posted earnings that were in line with our full-year earnings estimates with the exception of Supermax (NEUTRAL, TP: RM1.94) which recorded its fourth consecutive quarter of earnings disappointment. Due to this, we have slashed our earnings estimates for Supermax and revised our TP to RM1.94 (from RM2.11 previously). In addition, we have also downgraded Kossan Rubber Industries to NEUTRAL (from BUY previously) with an unchanged TP of RM7.57 due to the recent run up in the stock price. That said, most gloves manufacturers reported year-over-year improvement in earnings due to the recovery in average selling prices (ASPs) as well as the increase in volume sold as a result of revamp works on older production lines undertaken by most manufacturers. Hence, we believe that the current momentum will continue for the rest of the year given that demand remains strong at 8-10% per annum.

Table 1: Glove sector's earnings report card

Glove Companies	Upgrade/Downgrade	Previous Recommendation	New Recommendation	Previous TP	New TP
Hartalega	Maintained	NEUTRAL	NEUTRAL	RM6.99	RM6.99
Top Glove	Maintained	NEUTRAL	NEUTRAL	RM5.11	RM5.15
Kossan	Downgraded	BUY	NEUTRAL	RM7.57	RM7.57
Supermax	Maintained	NEUTRAL	NEUTRAL	RM2.11	RM1.94

Source: MIDFR

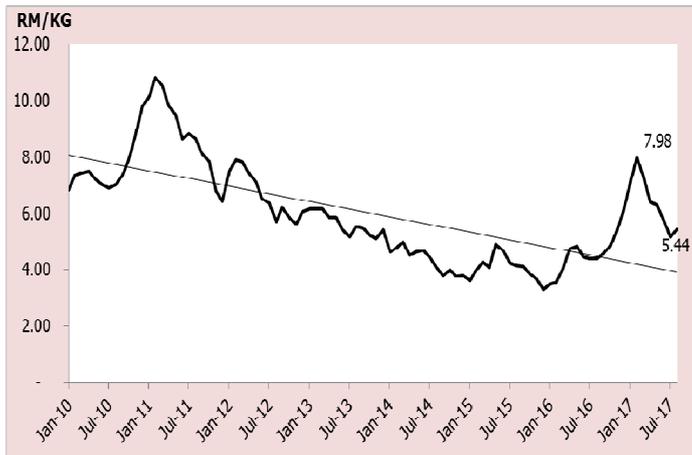
Earnings continue to be demand driven. The absence of new capacity coming from manufacturers such as Top Glove, Kossan and Supermax since early of this year proved to have caused limited earnings growth for these manufacturers. That said, we understand that Hartalega, Kossan and Top Glove will be adding 2.4b, 3.5b and 3.9b of new capacity respectively in 2HFY17 which we opine will assist in earnings growth for the rest of the year. Furthermore, some new developments in the industry such as: (i) China's participation in Paris Climate Agreement (PCA) which would drive the switch from vinyl plastic gloves to rubber gloves and; (ii) the ban on powdered medical and surgical gloves by the US Food and Drug Administration (FDA) which will help to spur additional demand for gloves.

Raw materials price on an increasing trend. We note that the raw material prices have been on an increasing trend due to several reasons: (i) upcoming International Tripartite Rubber Council meeting between major rubber producing countries i.e: Malaysia, Thailand and Indonesia intended to restore the falling price of raw natural rubber; (ii) recent statement by China where Chinese carmakers will now invest in hybrid and electric cars and; (iii) improved demand for the raw materials. Due to this, Malaysian Rubber Gloves Manufacturers Association (MARGMA) expects that ASPs for gloves will increase by 9-12% depending on the glove types to account for these increases. In addition, due to the increasing trend, we opine that natural rubber and nitrile butadiene prices will settle above RM6.00 per kg and above USD1,000 per tonne respectively by end-2017. That said, we do not foresee the increase in ASPs to disrupt demand as we understand that some major glove manufacturers have sold out capacity until December. However, the impact of the increase in ASPs will only be seen in 1QFY18 as typically glove manufacturers will require about two to three months to pass on the cost increases to their respective customers.

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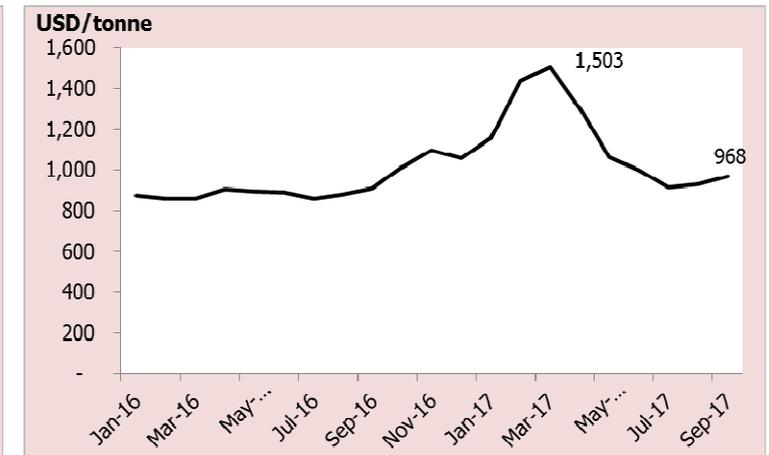
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Chart 1: Natural rubber price trend



Source: Malaysian Rubber Board (MRB), MIDFR

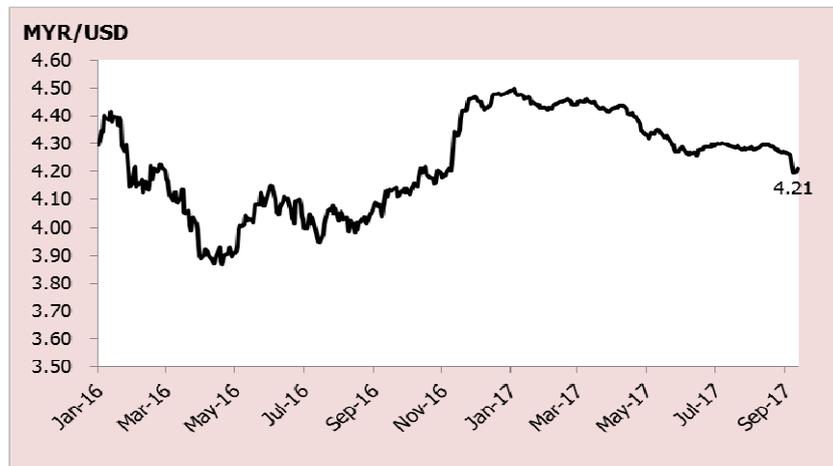
Chart 2: Nitrile butadiene price trend



Source: Bloomberg, MIDFR

Stable USD will be more beneficial to gloves manufacturers in the long term. Though a stronger USD will boost revenue for gloves manufacturers as the export of gloves are USD-denominated, however, we opine that the current stable USD condition is more beneficial to the gloves manufacturers in the long term as it provides better visibility in terms of both revenue as well as costs. In addition, it will also assist in currency hedging for the gloves manufacturers and reduce potential foreign exchange losses. Our house view with regards to USD to MYR is that MYR will continue to fluctuate at current level and settling at RM4.20 per USD by end-2017.

Chart 3: USD/MYR trend



Source: Bloomberg, MIDFR

Maintain NEUTRAL. All factors considered, we are reiterating our **NEUTRAL** stance on the sector as we remain cautious on the near term prospects for the glove industry. Despite expecting better performance for the sector this year with USD vs MYR rate remains stable and favourable to glove players, we do not discount the potential fluctuation coming from both raw materials price as well as currency which could potentially hurt earnings. In addition, we are also wary on the potential delay of capacity expansion plans by some of the major glove manufacturers as it could disrupt earnings growth. That said, the next leap in earnings and valuation will only happen post-2020 when all the capacity expansion plans conclude and new regulatory policies which could open new demand for nitrile gloves in the future.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.