Sector Update | Friday, 01 July 2022

GLOVES

***Maintain* NEUTRAL**

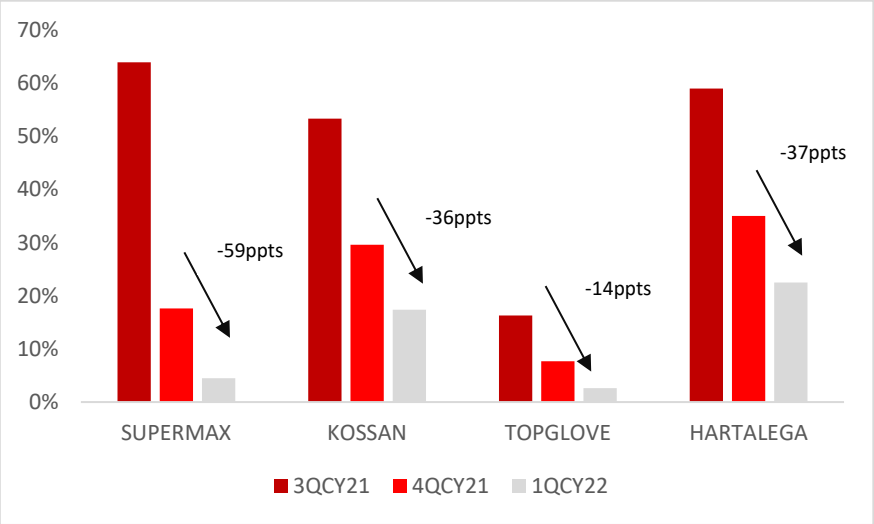
The effects of normalising ASP

KEY INVESTMENT HIGHLIGHTS

- **Yet to reach the ASP bottom**
- **Delays in expansion plan**
- **ESG issue, particularly allegations of forced labour, remains a major concern**
- **Maintain NEUTRAL due to declining ASP of gloves and rising cost; Hartalega (NEUTRAL, TP: RM3.09) remains our top pick**

Earnings on a downtrend. Thus far this year, the performance of glove companies under our coverage was all below expectations. The companies did not meet both our and consensus earnings expectations. The industry's lacklustre performance is due to the industry coming off a period of exponential growth as a result of the Covid-19 pandemic. The lower ASP coupled with rising production has put pressure on the players' margin in the glove industry (*Figure 1*). Even though some companies were able to increase sales volume, it was insufficient to compensate for falling ASP and rising costs. We opine that this situation will persist due to the world transition into the endemic phase.

Figure 1: PBT's margin for the last three quarters



Source: Companies, MIDFR

Reaching for bottom. The declining ASP has been the main constraint for the industry to expand. The downward trajectory in ASP was primarily caused by supply exceeding demand for the glove. The oversupply situation arises due to the nature of the business, which has low entry barriers. The majority of the new entrants came because the business appears lucrative during the pandemic, but the situation reversed when there are too many gloves supply in the market. Furthermore, incumbent players' expansion plans have had an impact on the ASP. The combination of these two factors resulted in higher supply and competition, causing the ASP to fall.

COMPANY IN FOCUS

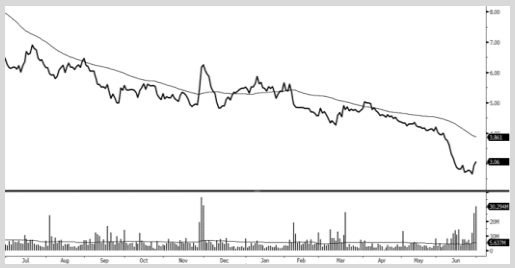
Hartalega Holdings

Maintain **NEUTRAL** | Revised target price: **RM3.09**

Price @ 30th June 2022: RM3.06

- High dividend yields
- Minimal ESG concerns
- Healthy cashflow and robust balance sheet (net cash of RM2.4b)

Share price chart



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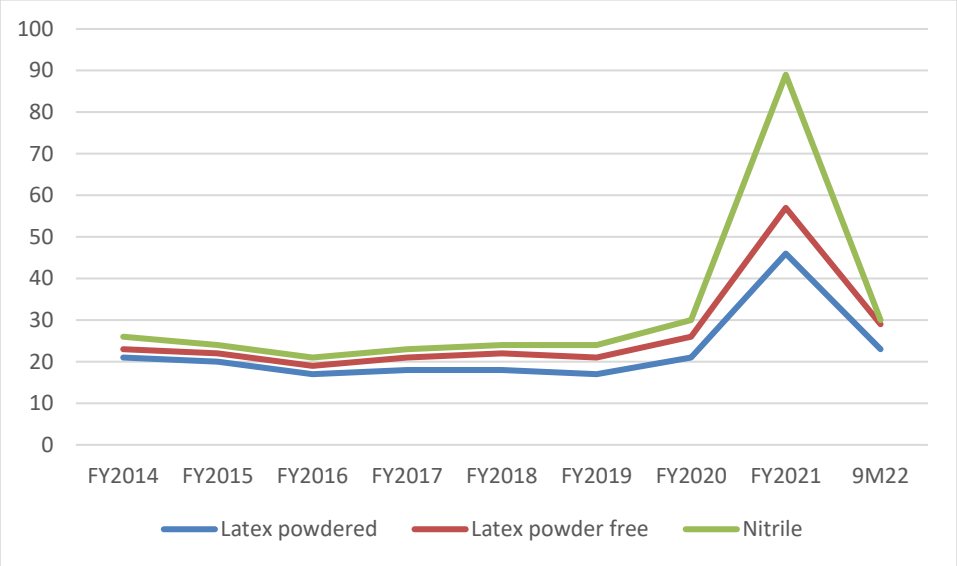
For 9MFY22, the ASP for latex powdered, latex powdered free, and nitrile gloves were at USD23, USD29, and USD30 per thousand pieces, respectively *(Figure 2)*. Moving forward, we believe volume and value will continue to fall before normalising. Nonetheless, we believe that the ASP will not return to pre-pandemic levels due to structural changes in glove usage and increased hygiene awareness.

Figure 2: ASP of Gloves, annually (USD/1000pcs)



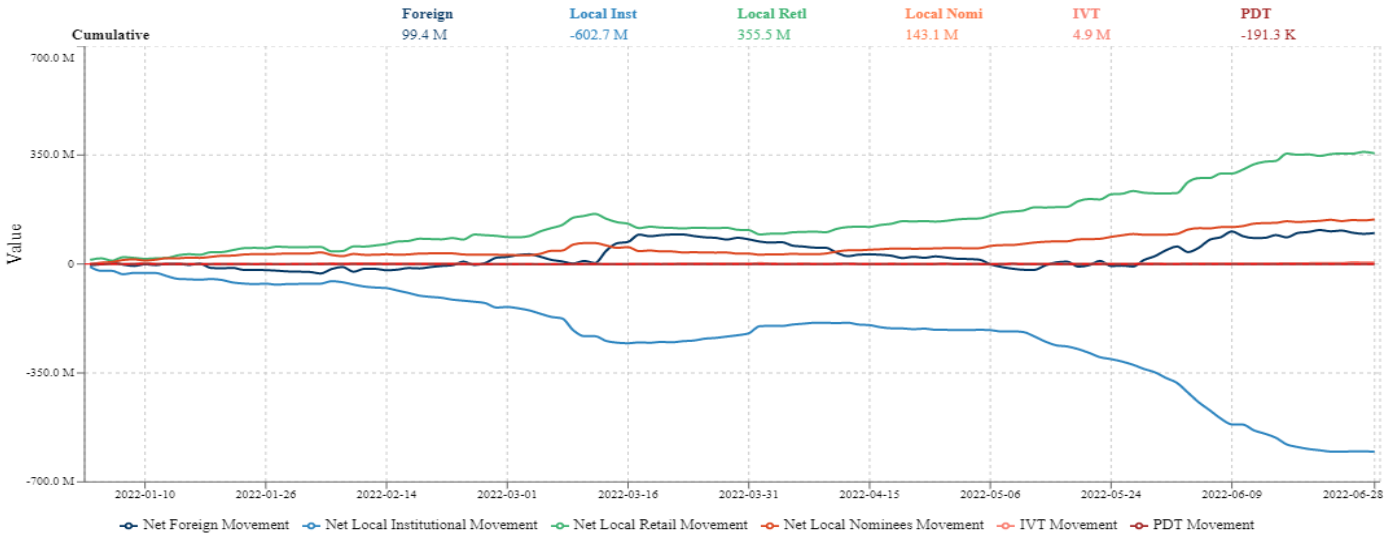
Source: Top Glove, MIDFR

Delay expansion plans. With the current industry utilisation rate being 50%-60%, we opine that the glove companies will put on hold their new capacity expansion plans. The oversaturated market has affected the capabilities of the players to pass through higher production cost (labour, fuel and electricity) to consumer. This circumstance has had a significant impact on their earnings. As a result, the most immediate action they can take is to delay their expansion plan in order to stabilise the ASP. In this regard, Top Glove has announced that they plan to defer their expansion plan (total of 32b pieces of gloves) for the next 4 years. However, we believe that the effectiveness of limiting additional production will take some years before the market reaches its optimum demand/supply level.

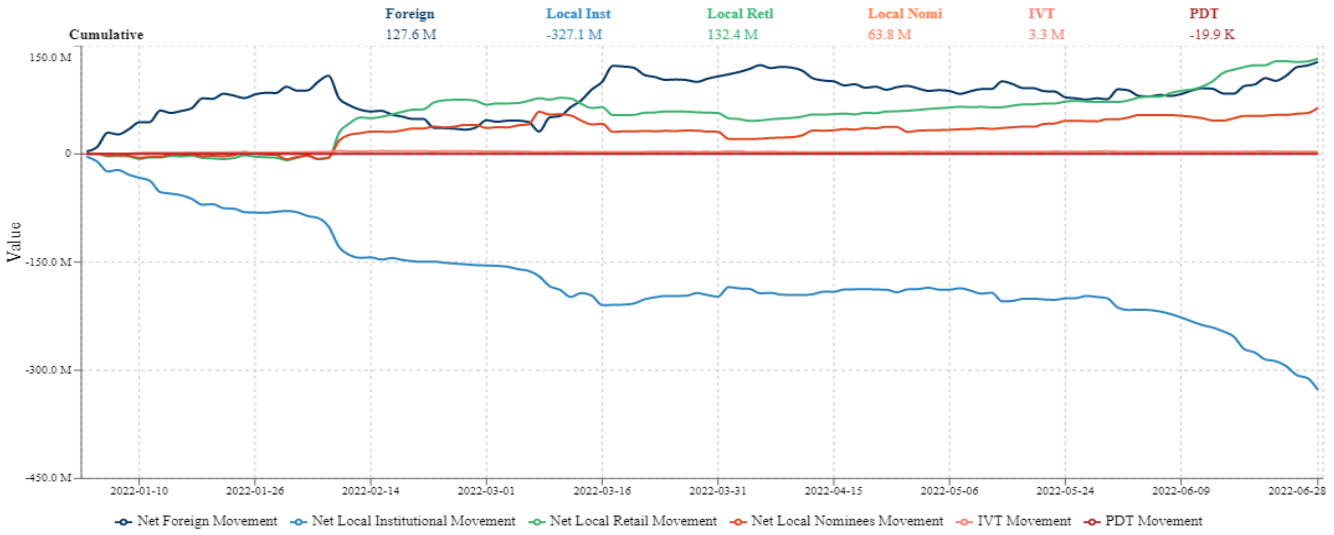
Concerns about ESG remain. With the imposition of a Withhold Release Order (WRO) by US Customs and Border Protection (CBP), as well as the recent termination of a sourcing contract for nitrile gloves from Canada due to allegations of forced labour for Supermax, we believe that ESG remains a serious issue in the gloves industry. The US Customs and Border Protection (CBP) import ban has cost the glove industry an estimated RM3.6 billion in potential glove export revenue, as announced by The Malaysian Rubber Gloves Manufacturers Association (MARGMA). Moreover, citing allegations of serious human rights violations, Norway's sovereign wealth fund has placed one of Malaysia's medical glove manufacturers under two-year surveillance. Despite implementing a foreign worker management policy to improve its labour standards to meet International Labour Organization (ILO) criteria, we believe there has been a gap in implementing the policies that led to its import bans in the US and Canada. As a result, we saw outflows year-to-date from Supermax by foreign investors beginning in January 2022 *(Figure 3)*. Likewise, during the same period, Kossan saw outflows of foreign investors. On the other hand, we have seen inflows year-to-date into Top Glove and Hartalega, arguably owing to their initiatives to ensure proper ESG compliance.

Figure 3: Fund movement from 1.1.2022 to 28.6.2022

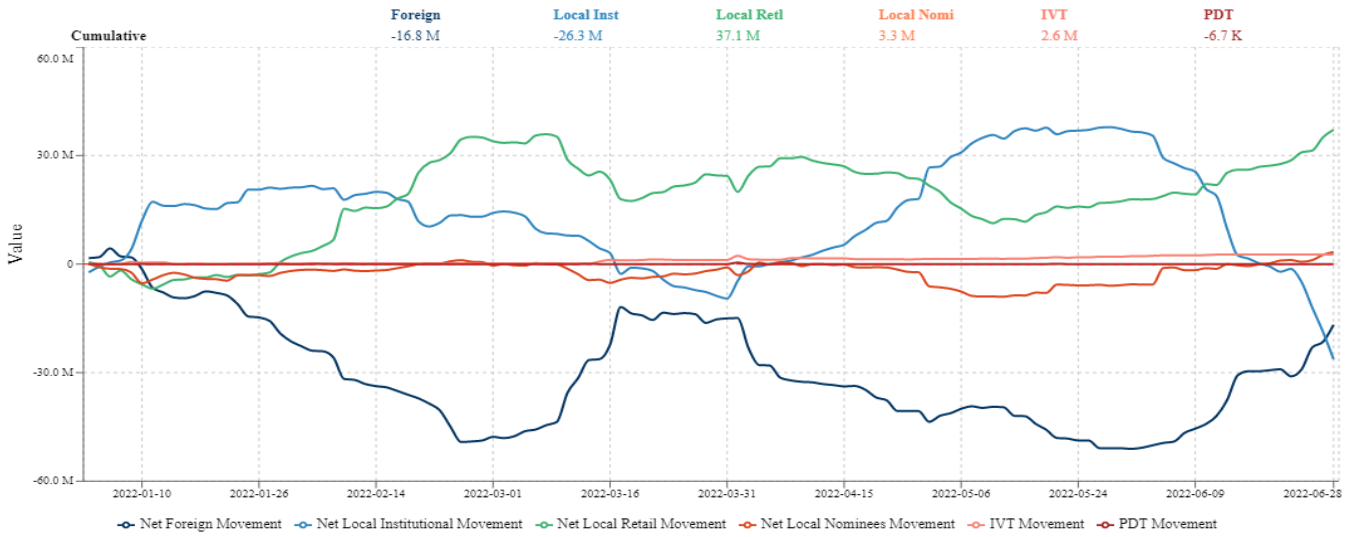
1) TOP GLOVE



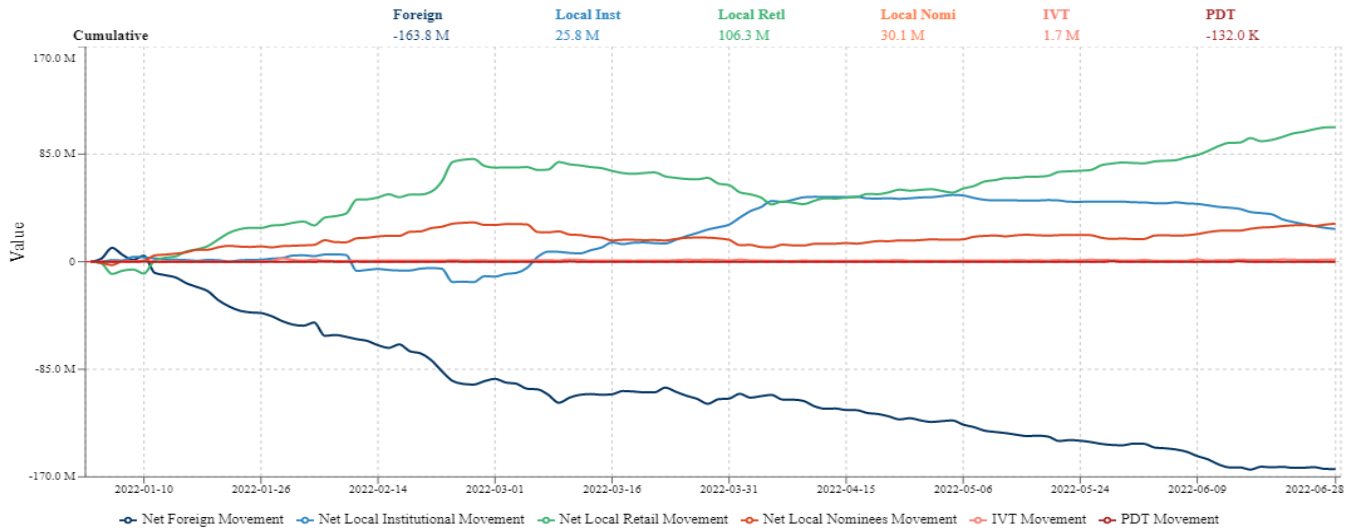
2) HARTALEGA



3) KOSSAN



4) SUPERMAX



Earnings forecast revised as we impute lower ASP and higher cost assumption. We have revised our ASP and cost assumption in view of transition to endemic phase and higher input cost. Hence, we lowered our earnings estimate for Hartalega's FY23F/FY24F by -16.2%/-4.9%, Kossan's FY22F/FY23F by -15%/-6.9%, Supermax's FY23F/FY24F by -47.8%/-47.4% and Top Glove's FY22F/FY23F/FY24F by -30.5%/-33.8%/-38.4%. Following the revision in our earnings estimates, we have adjusted our target prices accordingly. For Hartalega, our new TP of RM3.09 is based on 16.7x FY23F EPS of 18.5sen. Our new TP for Kossan is RM1.34, based on 10.2x FY23F EPS of 13.1sen. Meanwhile, the new TP for Supermax is RM0.88sen based on FY23F EPS of 10.0sen pegged to PER of 8.8x. The TP for Top Glove is now RM1.04 premised on FY23F EPS of 5.1sen pegged to 20.4x PER.

Figure 4: Changes in estimates and TP

Stock	FYE	Rec.	Target Price (RM)	Previous TP (RM)	Core EPS(sen)			Previous EPS (sen)			Change in EPS (%)	
					FY22E	FY23F	FY24F	FY22E	FY23F	FY24	FY22E	FY23F
Hartalega	Mar	NEUTRAL	3.09	4.31	95.1	18.5	20.1	95.1	22.1	21.1	0.0	-16.3
Kossan	Dec	NEUTRAL	1.34	1.66	12.8	13.1	10.1	15.1	14.0	10.1	-15.2	-6.4
Supermax	Jun	NEUTRAL	0.88	1.09	26.6	10.0	11.8	26.6	19.1	22.4	0.0	-47.6
Top Glove	Aug	NEUTRAL	1.04	1.29	4.3	5.1	7.3	6.2	7.7	11.8	-30.6	-33.8

Source: MIDFR

Maintain NEUTRAL. We continue to remain NEUTRAL on the gloves sector due to the declining average selling price (ASP), rising raw material prices, freight costs and lack of imminent catalysts. Risks to our call include (i) larger than expected movements in ASP, (ii) volatility in raw material prices, and (iii) exit of new entrants reduces the risk of oversupply. Our top sector pick is still **Hartalega (NEUTRAL, TP:RM3.09)** for their innovative approach towards automated production and focus on mitigating ESG risks. We are **NEUTRAL** on **Kossan (TP:RM1.34), Top Glove, (TP:RM1.04)** and **Supermax (TP:RM0.88)** as we think declining ASP remains to be a key risk factor, moving forward.

Figure 5: Peer comparison table

Stock	FYE	Rec.	Price @ 30/6/22	New TP (RM)	Core PE			Net DPS			Net Dvd Yield		
					FY22E	FY23F	FY24F	FY22E	FY23F	FY24	FY22E	FY23F	FY24F
Hartalega	Mar	NEUTRAL	3.06	3.09	3.2	16.5	15.3	53.5	11.1	12.0	17.5	3.6	3.9
Kossan	Dec	NEUTRAL	1.32	1.34	10.3	10.1	13.1	4.5	3.9	3.0	3.4	3.0	2.3
Supermax	Jun	NEUTRAL	0.88	0.88	3.3	8.8	7.5	10.6	3.1	3.8	12.1	3.5	4.3
Top Glove	Aug	NEUTRAL	1.04	1.04	24.2	20.4	14.3	2.2	2.5	3.6	2.1	2.4	3.5

Source: MIDFR

Figure 6: Investment Statistics for Hartalega Holdings

Financial year ending 31st March (in RM'm, unless otherwise stated)	FY2020	FY2021	F2022A	F2023F	F2024F
Revenue	**2961.3**	**6695.9**	**7888.3**	**3964.9**	**4455.9**
Cost of goods sold	-2328.6	-2891.5	-3317.8	-2911.2	-3300.5
Gross profit	**595.4**	**3804.4**	**4570.4**	**1053.7**	**1155.4**
Finance costs	-10.8	15.6	71.5	-4.0	-8.9
Profit before tax	**556.3**	**3813.4**	**4637.2**	**792.0**	**856.9**
PATANCI	435.8	2885.4	3234.7	633.6	685.5
Core PATANCI	**472.6**	**2975.4**	**3250.0**	**633.6**	**685.5**
EPS (sen)	14.2	84.4	95.1	18.5	20.1
EPS Growth (%)	3.4	493.9	12.7	-80.5	8.2
PER (x)	21.5	3.6	3.2	16.5	15.3
PBT margin (%)	18.8	57.0	58.8	20.0	19.2
PATANCI margin (%)	16.0	44.4	41.2	16.0	15.4
Dividend Per Share (sen)	7.6	54.8	53.5	11.1	12.0
Dividend yield (%)	2.5	17.9	17.5	3.6	3.9

Source: Company, MIDFR

Figure 7: Investment Statistics for Kossan Rubber Industries

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	FY2020	FY2021A	FY2022E	FY2023F	FY2024F
Revenue	**3653.5**	**6656.5**	**3266.8**	**3291.2**	**2980.5**
Operating Profit	1459.5	3752.8	423.5	431.9	336.5
PBT	1444.6	3746.7	407.2	415.4	321.6
PATANCI	**1092.6**	**2852.5**	**327.4**	**334.1**	**257.7**
Operating Profit margin (%)	39.9	56.4	13.0	13.1	11.3
PBT margin (%)	39.5	56.3	12.5	12.6	10.8
PATAMI margin (%)	29.9	42.9	10.0	10.2	8.6
EPS (sen)	42.5	133.8	12.8	13.1	10.1
EPS Growth (%)	141.5	214.9	-90.4	2.1	-22.8
PER (x)	3.1	1.0	10.3	10.1	13.1
Dividend per share (sen)	15.0	53.5	4.5	3.9	3.0
Dividend yield (%)	11.4	40.6	3.4	3.0	2.3

Source: Company, MIDFR

Figure 8: Investment Statistics for Supermax Corporation

Financial year ending 30th June (in RM'm, unless otherwise stated)	2020A	2021A	2022E	2023F	2024F
Revenue	**2,131.8**	**7,164.2**	**2,700.7**	**2,473.3**	**2,882.3**
Cost of goods sold	(1,444.3)	(2,136.7)	(1,690.5)	(2,092.2)	(2,438.3)
Gross profit	**687.5**	**5,027.5**	**1,010.2**	**381.0**	**444.0**
Finance costs	(17.1)	(8.2)	(21.6)	(19.8)	(23.1)
PBT	**688.5**	**5,019.3**	**1,000.5**	**372.2**	**433.7**
Taxation	(153.0)	(1,093.2)	(300.2)	(107.9)	(121.4)
PATANCI	**535.5**	**3,812.9**	**696.8**	**260.9**	**308.4**
PBT Margin (%)	32.3	70.1	37.0	15.0	15.0
PATANCI Margin (%)	25.1	53.2	25.8	10.6	10.7
EPS (sen)	40.2	145.5	26.6	10.0	11.8
EPS Growth (%)	756.0	261.8	(81.7)	(62.6)	18.2
PER (x)	2.2	0.6	3.3	8.8	7.5
Dividend (sen)	23.6	31.8	10.6	3.1	3.8
Dividend Yield (%)	26.8	36.1	12.1	3.5	4.3

Source: Company, MIDFR

Figure 9: Investment Statistics for Top Glove Corporation

Financial year ending 31st Aug (in RM'm, unless oterwise stated)	FY2020	FY2021	FY2022F	FY2023F	FY2024F
Revenue	**7236.3**	**16403.8**	**6321.0**	**6912.5**	**8094.2**
EBIT	2296.5	10051.1	533.0	619.7	891.5
PBT	2301.4	10155.9	403.0	477.6	684.6
PAT	1903.8	8005.1	350.6	415.5	595.6
PATANCI	**1867.0**	**7984.0**	**350.6**	**415.5**	**595.6**
Core PATANCI	1782.4	7984.0	350.6	415.5	595.6
EPS (sen)	23.1	98.6	4.3	5.1	7.3
EPS Growth (%)	62.0	327.6	-95.6	18.5	43.4
PBT margin (%)	31.8	61.9	6.4	6.9	8.5
PATANCI margin (%)	25.8	48.7	5.5	6.0	7.4
PER (x)	4.5	1.1	24.2	20.4	14.3
Dividend per share (sen)	11.8	65.1	2.2	2.5	3.6
Dividend yield (%)	11.3	62.6	2.1	2.4	3.5

Source: Company, MIDFR

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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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology