Sector Update | Monday, 27 March 2023

GLOVE

***Maintain* NEGATIVE**

Taking A Cautious Approach

KEY INVESTMENT HIGHLIGHTS

- **Raw material prices still on a roller coaster ride in the near term**
- **Normalizing global demand for rubber gloves**
- **Excess of gloves with low utilization rate to persist in 2023**
- **ASP treading carefully**
- **Revisions to the Hartalega and Kossan Rubber Industries' valuation methodology**
- **Maintain NEGATIVE on the sector**

Raw material prices still on a roller coaster ride in the near term. Raw material prices for glove manufacturer still on a roller coaster ride in the near term. NR Natural rubber gloves are formed mostly of latex concentrate, whereas nitrile gloves are produced of synthetic rubber, which is a combination of acrylonitrile and butadiene. Note that raw material costs account for 34-37% of total operational expenses.

On a yearly basis, the average prices of latex concentrate (-21.2%yoy) and acrylonitrile (-9.8%yoy) continued to fall in February 2023. Meanwhile, butadiene (+13.2%yoy) remained elevated in February 2023 due to increased demand from synthetic rubber downstream applications such as vehicle tires, paint, shoe bottoms, rubber gloves, and others. All three raw materials expanded on monthly basis, with Butadiene (+25.8%mom) taking the lead, followed by Acrylonitrile (+10%mom) and Butadiene (+4.5%mom). Moving forward, we expect the price of raw materials to remain high in the near term on the back of the reduced NR latex concentrate production amidst the winter season until May 2023 combined with the higher demand for Butadiene and Acrylonitrile. Overall, the raw material price fluctuation will affect the production cost of Malaysian glovemakers, namely **Hartalega (NEUTRAL, TP: RM1.80), Kossan Rubber (SELL, TP: RM0.95),** and **Top Glove (SELL, TP: RM0.55).**

Table 1: Average Monthly NR Latex concentrate, Butadiene, and Acrylonitrile statistics for Feb 2023

Data	Average monthly data				
	Feb-23	Jan-23	Feb-22	YoY (%)	MoM (%)
NR Latex Concentrate Price (USD/kg)	1.2	1.2	1.6	(21.2)	4.5
Butadiene (USD/kg)	1.2	0.9	1.0	13.2	25.8
Acrylonitrile (USD/kg)	1.6	1.4	1.7	(9.8)	10.0

Source: Bloomberg, MIDFR

COMPANY IN FOCUS

Hartalega Holdings Berhad

Maintain **NEUTRAL |** Revised Target Price: RM1.80

Price @ 24th Mar 2023: RM1.95

- Strong net cash position.
- Ability to generate positive operating cash flow.

Share price chart

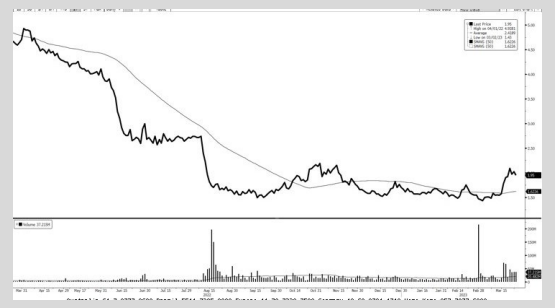

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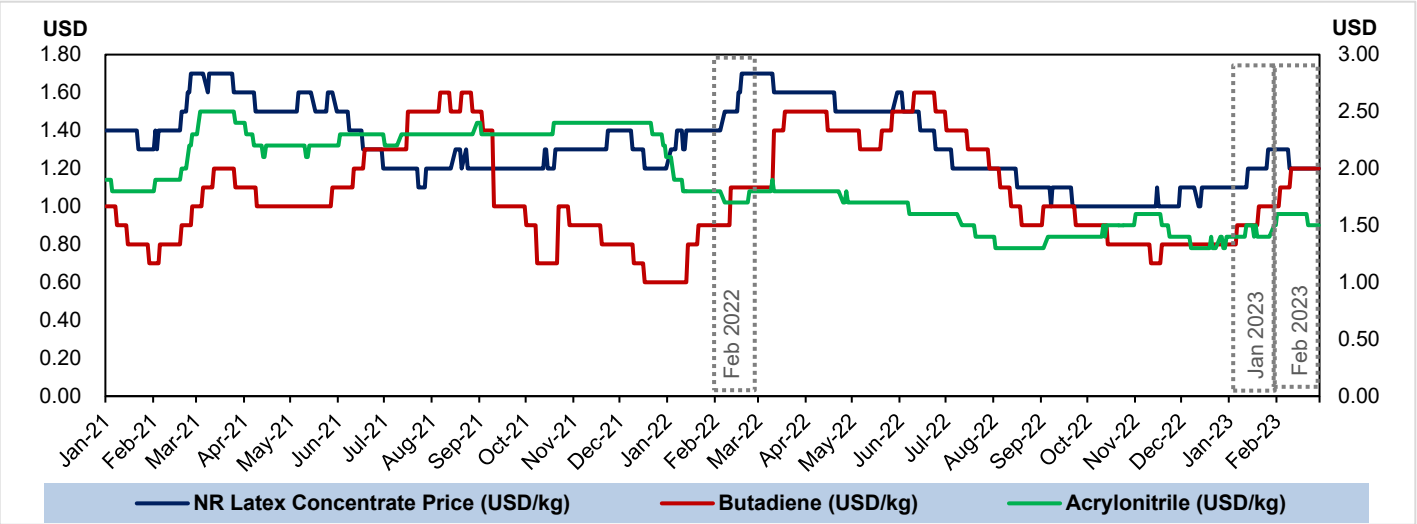
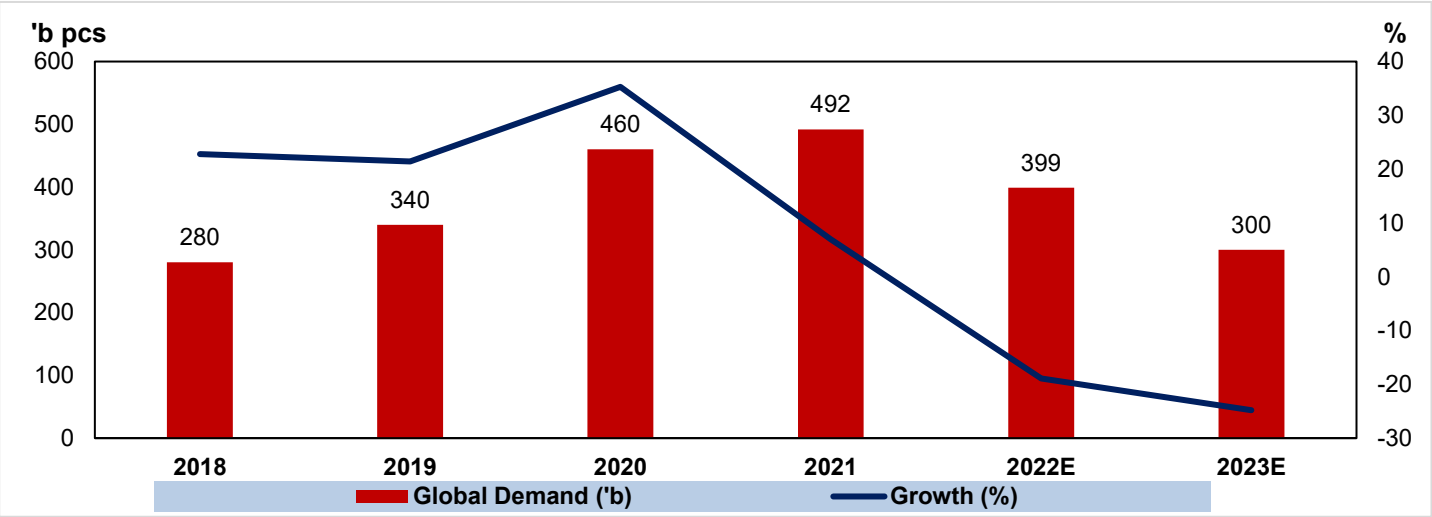
Chart 1: Raw Material Price Trend (USD/kg)



Source: Bloomberg, MIDFR

Normalizing global demand for rubber gloves. We gather that certain buyers may engage in some restocking activities in the near term amidst the old inventory is expected to deplete by end of 2023. However, we expect that the restocking activities will remain lackluster given that most countries have transitioned endemic phase post-border reopening. MARGMA is currently anticipating the global glove demand to normalize to pre-pandemic levels in 2023 (300b pieces of gloves) as compared to 280b pieces of gloves in 2018 and 340b pieces of gloves in 2019. With a normalized annual growth, we expect the demand for gloves throughout the world to normalize to pre-pandemic level.

Chart 2: Global glove demand (RM'b)



Source: Malaysia Rubber Glove Manufacturers Association (MARGMA)

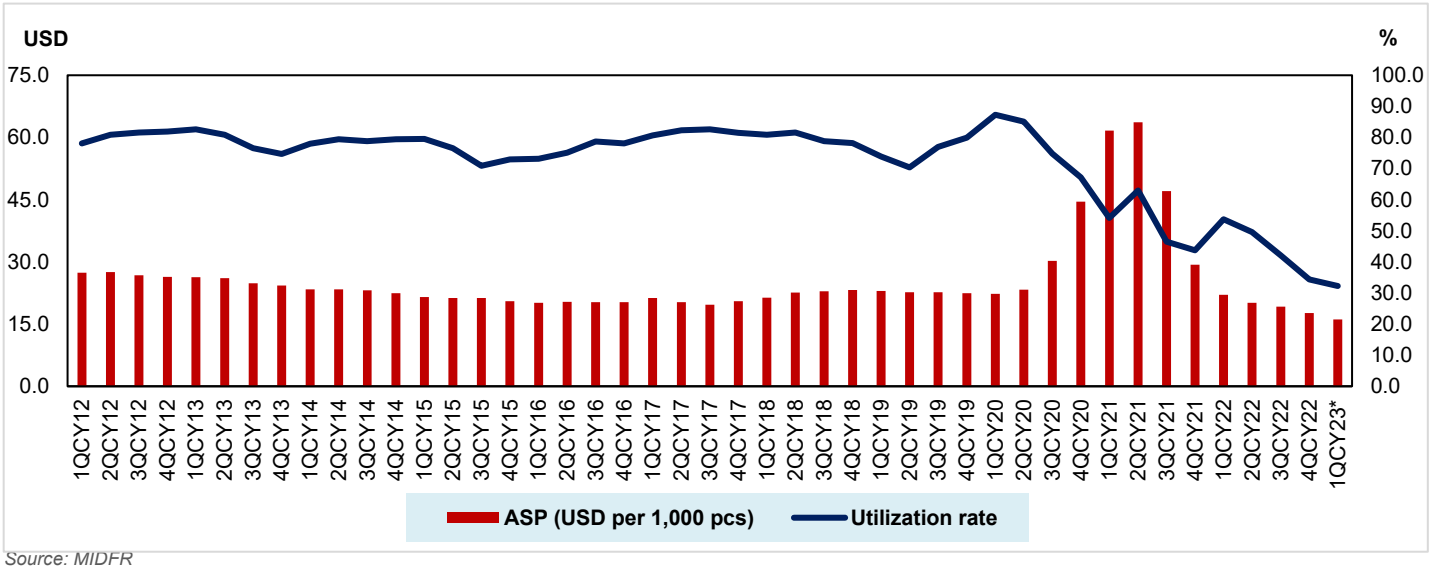
***E: MARGMA's Estimate

*2023E – Highlighted by MARGMA in the TEH TARIK Session for Kedah Rubber City.

Excess of gloves with low utilization rate to persist in 2023. The industry utilization rate fell from 35%-40% in 4QCY22 to 32-35% in 1QCY23, after excluding temporarily shut down inefficient plants. This was barely half of the 80–85% industry utilization rate in 2019. Based on our channel check, the number of glovemakers registered as MARGMA associate members has increased from under 60 (pre-pandemic) to 90 members (including subsidiaries) post-pandemic, equivalent to 20 new entries in Malaysia during the pandemic. Although some of the new entrants that entered during the pandemic have exited the market owing to the continuing losses, yet their production capacity in comparison to the total global supply of gloves is negligible, which might fail to mitigate the market's excess stock situation. Hence, we anticipate that the demand-supply dynamic is unlikely to return to normal for at least the next one years on the back of low utilization rate, normalizing glove demand and continuous intense competition in the industry. Looking ahead, we project a 35-40% industry utilization rate in 2023.

ASP treading carefully. Since 2QCY21, the industry's average selling prices have been falling due to an excess of gloves on the market. Local glove manufacturers were in the red over the last few quarters due to a combination of high cost of production per unit (caused by poor utilization rate) and low ASP which compressed profit margins. We noticed that numerous market participants started to raise ASP to pass costs forward. Based on our channel check, China's glovemakers increased their blended ASP from USD14/1k pieces to USD16/1k pieces in 1QCY23, equivalent to a 15% increase. As of 1QCY23, Hartalega plans to start passing some of its increased expenses forward to clients through ASP changes. Similarly, we understand Top Glove intends to raise the average selling price (ASP) by around 15–20%, to USD21/1k pieces. With most industry players considering raising ASP, we expect better success rate. However, we think there is limited room to fully pass on increased costs with greater price hikes in the near term owing to the continuous oversupply of gloves and the low level of cost competition among Malaysian and China's glove producers. Overall, we remain cautious about the price adjustment in the near term as we think that the ASP revision is merely testing the waters to gauge consumer reaction before committing to any greater price hike.

Chart 3: Industry-Blended ASP and Utilization rate



Source: MIDFR
**1QCY23-MIDFR's projection*

Revisions to the Hartalega and Kossan Rubber Industries' valuation methodology. Given that we expect near-term earnings for glovemakers will remain in the red in the near term, we think that the current Kossan Rubber (PER valuation technique) and Hartalega (DDM-valuation method) valuation methods are no longer suitable. We altered our valuation methodology for all glovemakers under our coverage to the price-to-book methodology, given their strong balance sheet position that could better reflect their long-term outlook. We raised our **target price** for **Kossan Rubber** to **RM0.95 (from RM0.88)** based on its 2-year historical -1SD P/BV of 0.59x pegged to FY23F BVPS of 161sen. For **Hartalega**, our **TP revised to RM1.80 (from RM1.60)** is based on its 2-year historical -1SD P/BV of 1.2x multiplied by FY23F BVPS of 151sen. Meanwhile, we make no changes to our forecast and recommendation for Kossan and Hartalega. We maintain a SELL recommendation for Kossan Rubber and a NEUTRAL call for Hartalega.

Valuation. All the glovemakers under our coverage are trading at a discount of 33-52% to their 2-year historical mean P/BV. We believe that this is justifiable, considering the continuous downside risk to their company's profitability. Hence, we're holding off on bottom fishing until we have more information about the customer reaction to the ASP hike.

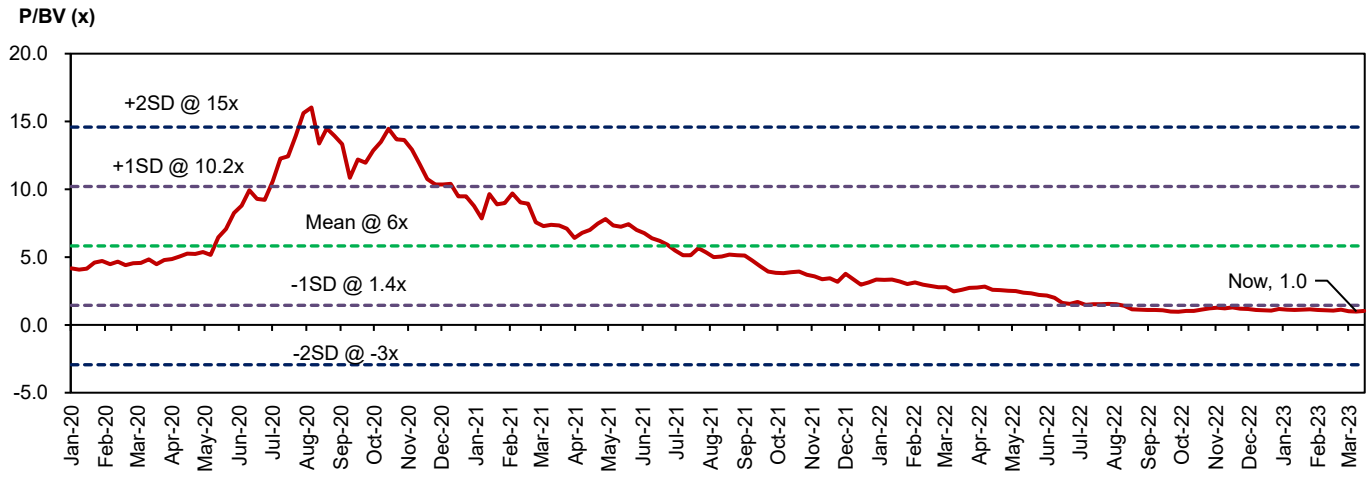
Maintain NEGATIVE on the sector. We remain cautious about the outlook due to the continuous intense competition combined with the normalizing glove demand which resulted in the oversupply of gloves. Hence, we maintain our view that the demand-supply dynamic is unlikely to revert to normal at least in the next 1 year. Even though the industry has started to hike ASP to pass on costs, we are adopting a wait-and-see approach in the near-term regarding consumer response to the ASP hike. This is because clients may easily move to other firms due to an ongoing surplus of gloves on the market. We are also wary that the margin compression will persist in the near term on the back of the cost of production per unit remaining high due to the ongoing poor utilization rate. Hence, maintain **NEGATIVE** in the near term. Our top pick for the sector is **Hartalega (NEUTRAL, TP: RM1.80).** We prefer Hartalega due to its substantial net cash position of RM1.9b (equivalent to 27% of market capitalization), which may serve as a buffer against any potential downside risk. We also prefer Hartalega because of its ability to generate positive operating cash flow despite multiple headwinds.

Table 2: Peers valuation matrix

Companies	Rec.	S.Price	Target Price	Mkt. Cap (RM'm)	EPS (sen)		PER (x)		P/BV (x)		Net Cash/ Mkt. Cap
		@24-Mar			CY22	CY23F	CY22	CY23F	CY22	CY23F	
Hartalega Holdings	NEUTRAL	RM1.95	RM1.80	6,664.9	26.3	5.8	7.4	33.8	1.31	1.30	28.5
Kossan Rubber Industries	SELL	RM1.35	RM0.95	3,445.2	5.2	3.3	25.9	40.7	0.84	0.83	27.9
Top Glove Corp	SELL	RM0.96	RM0.55	7,651.5	2.1	(3.9)	46.6	(24.3)	1.14	1.15	4.2
Simple mean					**11.2**	**1.7**	**26.6**	**16.7**	**1.09**	**1.09**	**20.2**
Weighted Avg. Mean					**11.8**	**1.1**	**27.9**	**10.1**	**1.14**	**1.14**	**17.9**

Source: MIDFR

Chart 4: 3-Year Forward P/BV Band



Source: 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 news flow.
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