

Thong Pak Leng

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Rationale for report: Sector update

Investment Highlights

- **Maintain NEUTRAL.** We are maintaining our **NEUTRAL** view on the sector as valuations for glove companies under our coverage (**Top Glove, Kossan and Hartalega**) are already fully reflected in the companies' earnings outlook. We reckon the average selling prices (ASP) will begin to ease after 1H2021 following the strong increase over the past 9 months, and are already priced in. Moreover, we are cutting our target PER by 10% across the board to take into account the risk of a down cycle in the sector as a result of successful rollouts of Covid-19 vaccines. While we believe that glove makers' fundamentals remain steady for the next few years, they offer limited upside at their current share prices. Hence we advise investors to accumulate at lower levels.
- **Demand will remain stable post-Covid-19.** The Malaysian Rubber Glove Manufacturers Association (Margma) expects demand for gloves to remain positive post-Covid-19. The main reason is the pandemic has raised much awareness on personal hygiene, thus resulting in a higher usage of gloves. In developing countries, the usage of gloves is increasing with a wider adoption of gloves usage from non-medical industries such as F&B, services, retail etc. Beyond the pandemic, we anticipate a structural change in the way gloves are used, forming a new normal where glove usage per capita will rise as hygiene measures become stricter. This is expected to apply not only in the healthcare sector but also across different industries like F&B. The glove consumption per capita in emerging markets such as India and China is still low at around 2–6 gloves as opposed to about 100–280 gloves for developed countries.
- **Capacity expansion.** Glove companies will continue their expansion plan, adding about 120bil (+55%) pcs per annum by the end of 2022 (Exhibit 2). For Malaysian companies, Top Glove and Supermax will see the biggest expansion as they add 30bil and 22bil pcs respectively, followed by Hartalega (12bil) and Kossan (10bil). The rest of the additional capacity will be from Sri Trang (Thailand), Intco Medical and Blue Sail (both China), totalling about 56bil pcs per annum.
- **ASP to taper off in 1H2021.** Although we hold the view that demand for gloves will remain stable post-Covid-19, we expect ASP to decline as there is no longer a rush for gloves compared to what happened at the beginning of the pandemic. Nonetheless, we expect ASP will stabilise at a higher level than the pre-pandemic level due to the broader usage of gloves. Moreover, capacity expansion from glove companies will be able to cope with the future demand.
- **Rising raw material prices.** Rubber prices have been increasing over the past 12 months as protective glove demand surges due to Covid-19. At the same time, the price of butadiene (Exhibit 4), which is the key ingredient to produce nitrile, has also been on the rising trend over the past 6 months. Nonetheless, we believe glove makers will be able to pass on the price increase to buyers, thus keeping their margins safe.
- **Maintain our HOLD call on Top Glove with a fair value (FV) of RM6.50 per share.** We forecast Top Glove's net profit at **RM7.9bil**, RM2.7bil and RM1.5bil for FY21–23F respectively. Our ASP assumptions for FY21–23 are US\$82/1,000 pcs, US\$30/1,000 pcs and US\$25/1,000 pcs respectively. Our FV of RM6.50 is based on CY22 EPS over a PER of 23x.
- **Maintain our HOLD call on Hartalega with a FV of RM12.25 per share.** We expect Hartalega to register net earnings of RM2.1bil, RM1.3bil and RM1.1bil for FY21–FY23 respectively. Our ASP assumptions for FY21–FY23 are US\$40/1,000 pcs, US\$33/1,000 pcs and US\$32/1,000 pcs. Our FV of RM12.25 per share is based on its 5-year average PER of 35x over CY22EPS.
- **Maintain our HOLD call on Kossan with a FV of RM4.80 per share.** We are forecasting net earnings of RM903.8mil, RM1.4bil and RM511.3mil for FY20–FY22 respectively based on ASP assumptions of US\$31/1,000pcs, US\$40/1,000 pcs and US\$29/1,000 pcs. Our FV of RM4.80 per share is based on its 5-year average PER of 24x over FY22 EPS.

EXHIBIT 1: VALUATION MATRIX

Companies	Recommendation	Price (RM)	FV (RM)	Upside (%)	Mkt Cap (RMmil)	FYE	EPS (sen)		EPS growth (%)		P/E (x)		P/B (x)	ROE (%)	NDPS (sen)	Div Yield (%)
							FY20F	FY21F	FY20F	FY21F	FY20F	FY21F				
Hartalega	HOLD	12.22	12.25	0.2%	40,878.2	Mar	61.6	39.0	376.9%	-36.8%	19.8	31.4	12.2	69.8%	37.0	3.0%
Kossan	HOLD	4.56	4.80	5.3%	11,663.9	Dec	35.3	53.4	301.1%	51.3%	12.9	8.5	5.9	53.3%	14.0	3.1%
Top Glove	HOLD	6.68	6.50	-2.7%	54,684.5	Aug	96.8	33.5	318.9%	-65.4%	6.9	19.9	6.0	103.3%	63.0	9.4%
Weighted Average									339.1%	-41.8%	12.5	23.1	8.4			

* FY20F and FY21F refer to FY21F and FY22F

Source: AmInvestment Bank

EXHIBIT 2: CAPACITY EXPANSION

Companies	Estimated capacity		
	CY20E	CY21F	CY22F
Top Glove	89.1	106.4	119.2
Hartalega	41.2	45.5	53.6
Kossan	32.0	35.4	42.4
Supermax	26.2	36.4	48.4
Sri Trang	32.6	35.7	45.8
Intco Medical	8.2	16.7	24.7
Blue Sail	5.0	12.7	31.8
Total	234.3	288.8	365.9

Source: Company/AmInvestment Bank

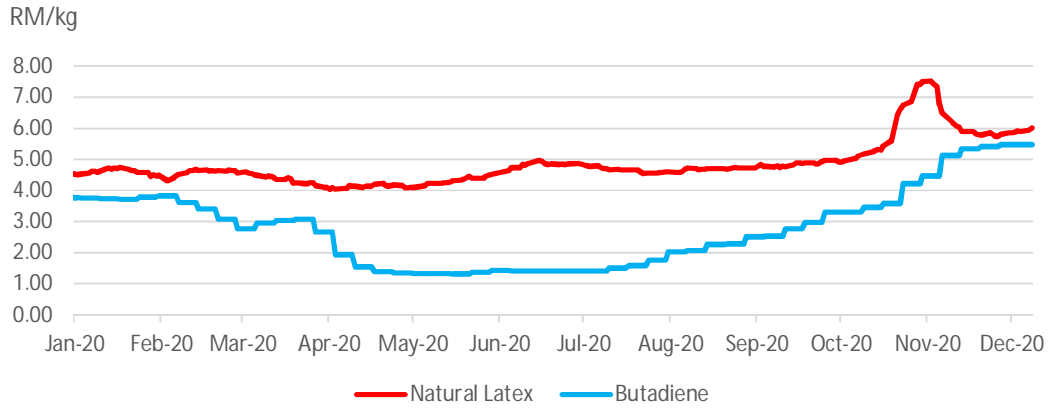
EXHIBIT 3: KEY ASSUMPTIONS IN OUR EARNINGS ESTIMATES

Top Glove FYE Aug	FY21F	FY22F	FY23F
Revenue (group total) (RM' mil)	25,597.1	10,234.1	8,741.2
Net Profit (RM' mil)	7,920.3	2,742.9	1,457.4
ASP (USD/1000 pcs)	82.0	31.0	25.0
Utilisation rate	70%	75%	75%
Natural rubber/Nitrile price (RM/kg) *	5.90	6.00	6.20
MYR/USD exchange rate *	4.25	4.05	3.98
Hartalega FYE Mar	FY21F	FY22F	FY23F
Revenue (group total) (RM' mil)	6,201.1	5,128.4	5,125.7
Net Profit (RM' mil)	2,061.4	1,303.6	1,127.2
ASP (USD/1000 pcs)	40.0	33.0	32.0
Utilisation rate	87%	83%	81%
Natural rubber/Nitrile price (RM/kg) *	5.90	6.00	6.20
MYR/USD exchange rate *	4.25	4.05	4.00
Kossan FYE Dec	FY20F	FY21F	FY22F
Revenue (group total) (RM' mil)	4,016.2	5,479.6	4,671.0
Net Profit (RM' mil)	903.8	1,365.0	511.3
ASP (USD/1000 pcs)	31.0	40.0	29.0
Utilisation rate	91%	89%	88%
Natural rubber/Nitrile price (RM/kg)	5.90	6.00	6.20
MYR/USD exchange rate	4.25	4.05	3.98

* FY refers to CY

Source: Company/AmInvestment Bank

EXHIBIT 4: NATURAL LATEX & BUTADIENE PRICES



Source: Bloomberg/AmInvestment Bank

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