

02 January 2020

# Rubber Gloves

## Demand To Bounce Up

By Raymond Choo Ping Khoon | [pkchoo@kenanga.com.my](mailto:pkchoo@kenanga.com.my)

**OVERWEIGHT**



Maintain OVERWEIGHT. Our investment case is based on: (i) nascent signs from industry leaders pointing towards a strong rebound in volume growth, (ii) nitrile gloves market share to gain further momentum, potential 30% growth in nitrile and (iii) expected earnings growth driven by new capacity expansion. Due to the intense competition in the latex segment, we would focus on players which are largely nitrile-centric including HARTA and KOSSAN. We have OUTPERFORM call on HARTA (OP; TP: RM6.00); KOSSAN (OP; TP: RM5.25) and SUPERMX (OP; TP: RM1.75). Our Top Pick in the sector is HARTA (OP; TP: RM6.00). We like HARTA for: (i) its “highly automated production processes” model, which is moving from ‘good’ to ‘great’ as they are head and shoulders above peers in terms of better margins and costs reduction, (ii) constantly evolving via innovative products development, and (iii) its nitrile gloves segment, which is booming.



**3QCY19 results season pleasantly within expectations.** 3QCY19 results season for glove makers under our coverage came in within expectations. The star performer was Hartalega which recorded the second consecutive quarterly earnings growth where it achieved mid-teens sales volume growth (+14%) in 2QFY20 driven by new capacity from Plant 5. We continue to remain positive on sequential earnings recovery to gather momentum in subsequent quarters, underpinned by uptick in nitrile demand, to be driven by re-stocking activities. Kossan's 3QFY19 results came in disappointingly lower YoY and QoQ despite having new capacity from Plant 17 and 18 due to an unexpected labour shortage in 3QFY19 which came without any warning. However, the labour shortage has been resolved. Supermax and TOPG's 1QFY20 results both showed strong sequential recovery following the easing of input latex raw material cost.

**Stage set for a recovery in volume growth.** More importantly, there are nascent signs of a solid uptick in demand for rubber gloves in subsequent quarters. 3QCY19 results season indicated a positive recovery in demand and hence volume growth from industry leaders - TOPG and HART. Both players recorded 6% and 14% sequential volume growth, respectively. From our ground checks, demand for nitrile gloves is picking up again where players' new capacities are being swiftly taken up. We believe this uptick in demand is turning positive and should be reflected in players bottom-line in subsequent quarters.

**Nitrile gloves' market share to gain further momentum with potential 30% growth.** Based on our analysis, we expect nitrile gloves to continue growing and grabbing market share from latex gloves. The growth in nitrile segment is evident. For illustration purposes, going forward, assuming Nitrile:Latex breakdown of 80:20 (current is 67:37) and based on estimated global demand of 308b pieces in 2020 (forecast for 2019 is 300b pieces and assuming 8% growth rate in 2020), this implies nitrile growth rate of 30% or an additional 51b pieces from switching to nitrile gloves.

**Uptick in nitrile demand but intense competition for latex.** Looking ahead, the keen competition in the latex segment could negatively impact latex gloves margin. The robust demand for nitrile gloves has led to longer delivery lead times to between 45 to 50 days as compared to 30 to 40 days previously. Although we are positive on growth in subsequent quarters underpinned by uptick in nitrile demand driven by re-stocking activities, players like TOPGLOV and SUPERMX could continue to be plagued with competitive pressure from low margin latex gloves (accounts for an estimated 50% of product mix for both players) which could offset the gains in the nitrile segment.

Investors should focus on nitrile-centric players. Due to the intense competition in the latex segment, we recommend players which are largely nitrile-centric including HARTA and KOSSAN which product mixes hinge largely towards nitrile at 95% and 75% share, respectively. Conversely, TOPGLOV and SUPERMX which are largely latex-centric with product mix between nitrile and latex estimated at 50%:50% are expected to face margins pressure.

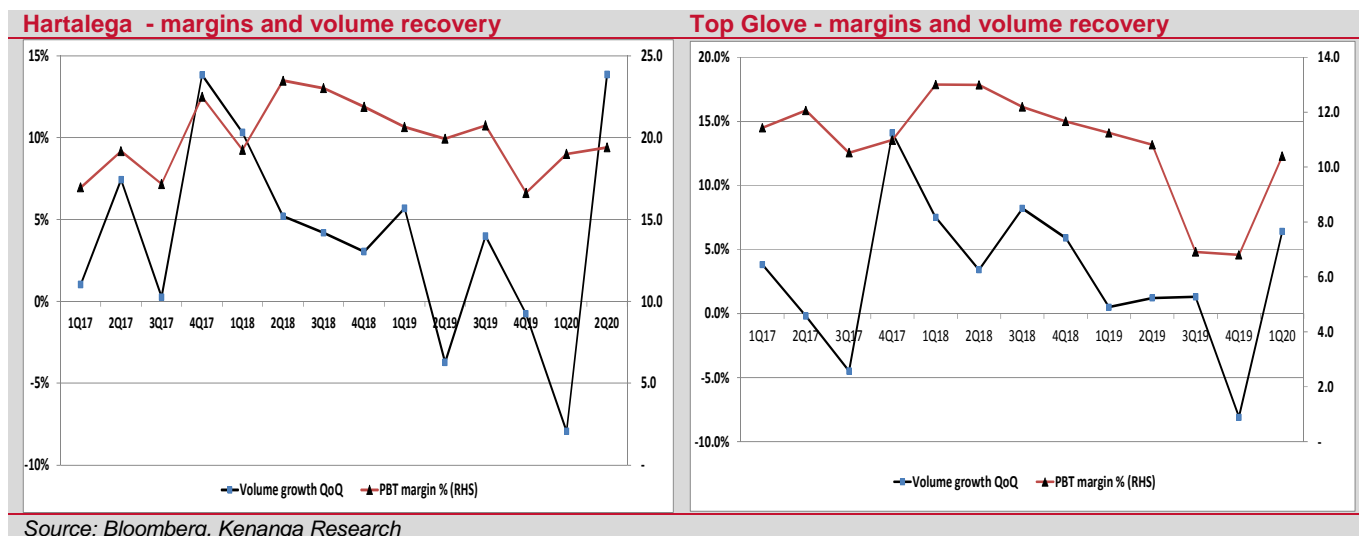
**Our Top Pick in the sector is HARTALEGA.** We like HARTA for: (i) its “highly automated production processes” model, which is moving from ‘good’ to ‘great’ as they are head and shoulders above its peers in terms of better margins and reduction in costs, (ii) constantly evolving via innovative products development, and (iii) its nitrile gloves segment, which is booming. Our TP is RM6.00 based on unchanged 36x FY21 EPS (at +1.0SD above 5-year historical forward mean).



02 January 2020

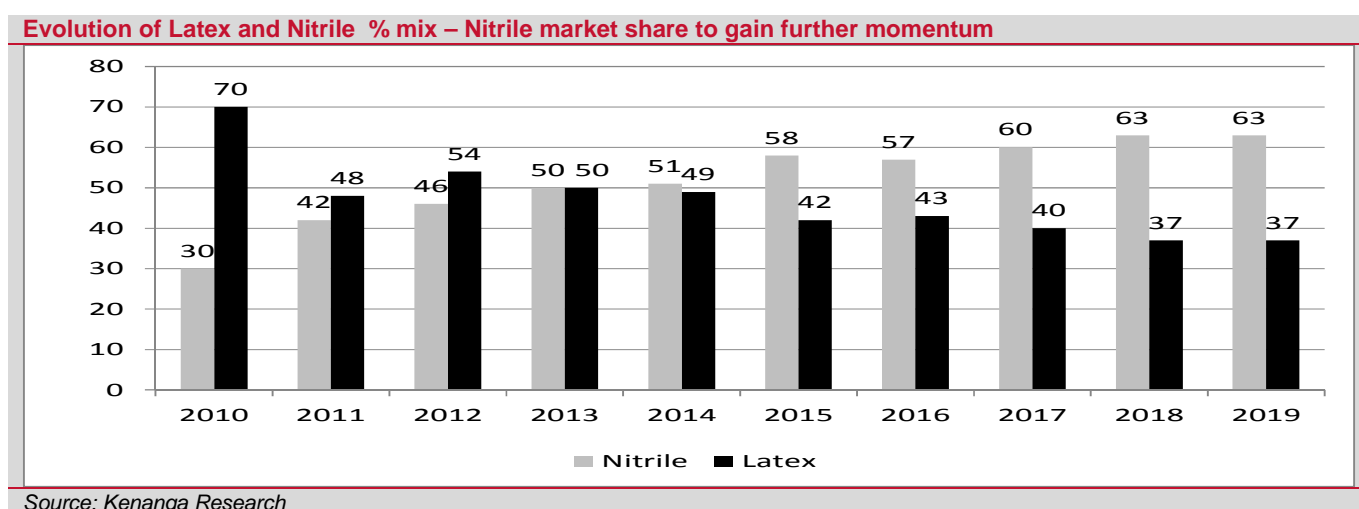
## KEY POINTS

**Stage set for a recovery in volume growth.** Nascent signs of a solid uptick in demand are emerging for rubber gloves in subsequent quarters, benefitting the players. 3QCY19 results season indicated a positive recovery in demand and hence volume growth from industry leaders - TOPG and HART. Both players recorded 6% and 14% sequential volume growth, respectively. From our ground checks, demand for nitrile gloves is picking up again with players' new capacities being swiftly taken up. We believe this uptick in demand is turning positive and should be reflected in players' bottom-line in subsequent quarters. Hartalega's 2QFY20 bottom-line achieved a second consecutive sequential QoQ growth. Separately, TOPG showed a solid recovery in earnings underpinned by 6% volume growth attributed to nitrile segment (+12%) but lower latex segment.



**Uptick in nitrile demand but intense competition for latex.** Looking ahead, the keen competition in the latex segment could negatively impact latex gloves margin. The robust demand for nitrile gloves has led to longer delivery lead times to between 45 to 50 days as compared to 30 to 40 days previously. Although we are positive on growth in subsequent quarters underpinned by uptick in nitrile demand driven by re-stocking activities, players like TOPGLOV and SUPERMX could continue to be plagued with competitive pressure from low margin latex gloves (accounts for an estimated 50% of product mix for both players) which could offset the gains in the nitrile segment.

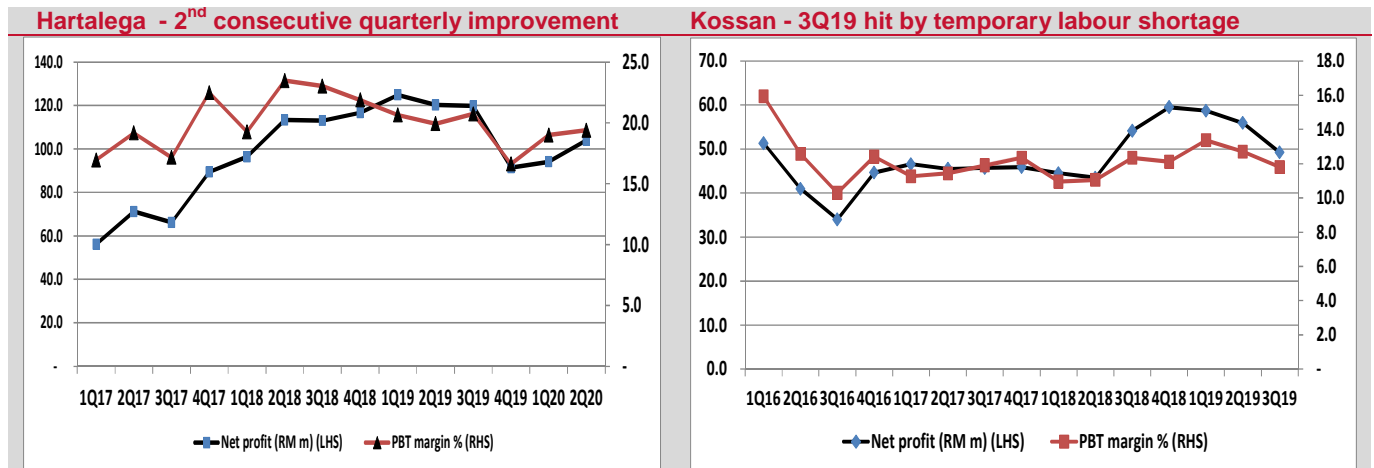
**Nitrile gloves market share to gain further momentum, potential 30% growth in nitrile.** Based on our analysis, we expect nitrile gloves to continue growing and taking market share away from latex. The growth in nitrile segment is evident. For illustration purposes, assuming going forward Nitrile : Latex is 80 : 20 (current is 67 : 37) and based on global demand and an estimated 308b pieces in 2020 (forecast in 2019 is 300b pieces and assuming a 8% growth rate in 2020) implying nitrile growth rate at 30% or an additional 51b pieces of switching to nitrile.



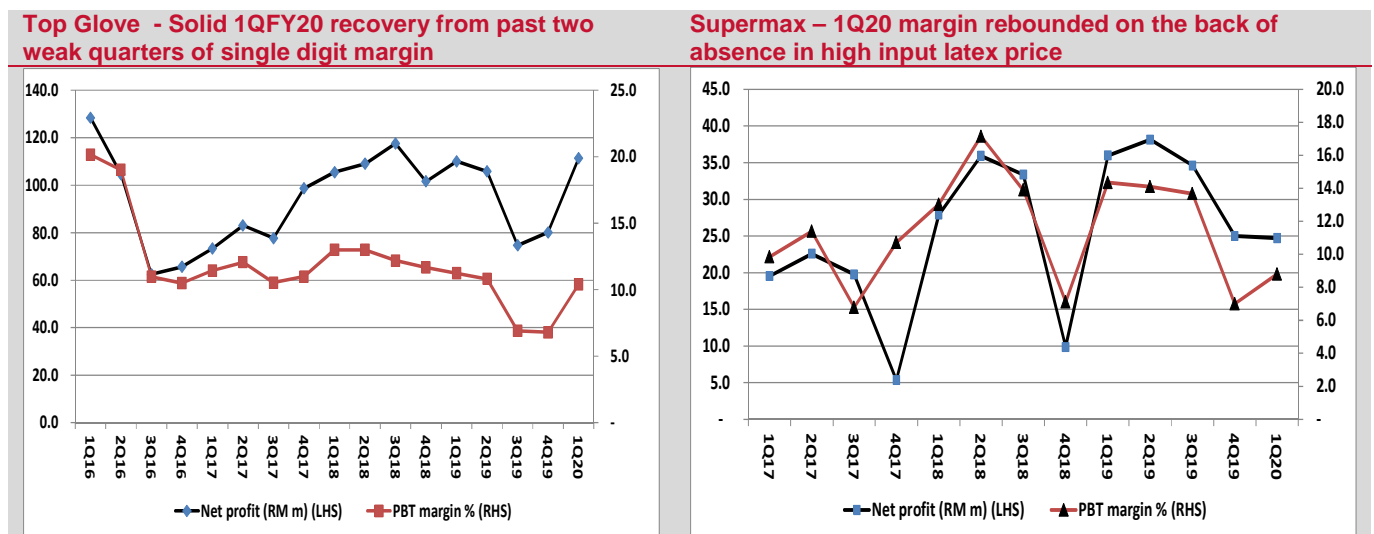
**Investors should focus on nitrile-centric players.** Due to the intense competition in the latex segment, we recommend players which are largely nitrile-centric including HARTA and KOSSAN which product mixes hinge largely towards nitrile at 95% and 75% share, respectively. Conversely, TOPGLOV and SUPERMX have higher concentration of latex-based gloves with product mix between nitrile and latex estimated at 50%:50% which are expected to face margins pressure.

02 January 2020

**3QCY19 results season pleasantly within expectations.** 3QCY19 results season for glove makers under our coverage came in within expectations. The star performer was HARTA which recorded the second consecutive quarterly earnings growth with its 2QFY20 achieving mid-teens sales volume growth (+14%) driven by new capacity from Plant 5. We continue to remain positive on sequential earnings recovery to gather momentum in subsequent quarters, underpinned by uptick in nitrile demand, to be driven by re-stocking activities. Kossan's 3QFY19 results came in disappointingly lower YoY and QoQ despite having new capacity from Plant 17 and 18 due to an unexpected labour shortage in 3QFY19 which came without any warning. However, the labour shortage has been resolved. Supermax and TOPG's 1QFY20 results both showed strong sequential recovery following the easing of input latex raw material cost.



Source: Bloomberg, Kenanga Research



Source: Bloomberg, Kenanga Research

**Lower natural gas price a positive tailwind.** Gas Malaysia in an announcement to Bursa Malaysia informed that the Government has approved a natural gas tariff revision for non-power sectors in Peninsular Malaysia with effect from 1 Jan 2020 to 31 December 2020 lowered by an average of -2.9%. Fuel accounts for an average of 12% of production cost, of which natural gas accounts for an average of 7% of the production cost. Ceteris paribus, assuming "no-cost savings pass-through", an average 2.9% reduction in natural gas tariff is expected to only marginally raise rubber gloves players' earnings by +0.2% based on our back-of-envelope calculations. Generally, it takes approximately between one to three months to pass through the cost reduction.

02 January 2020

**Structure of the revised natural gas tariff – average -2.9% reduction**

Tariff Category	Average Annual Gas Consumption (MMBtu)	Current Base Tariff (RM/MMBtu)	Current Tariff After Surcharge (RM/MMBtu)	Tariff After Surcharge for 15 Jul–31 Dec 2019 (RM/MMBtu)	Base Tariff for 1 Jan – 31 Dec 2020 (RM/MMBtu)
A	Residential	23.49	23.72	25.44	25.10
B	0 – 600	30.35	30.58	32.32	31.71
C	601 – 5,000	30.51	30.74	32.48	31.86
D	5,001 – 50,000	30.81	31.04	32.78	32.15
E	50,001 – 200,000	32.15	32.38	34.12	33.45
F	200,001 – 750,00	32.15	32.38	34.12	33.45
L	Above 750,000	33.23	33.46	35.20	33.99
<b>Average</b>		32.69	32.92	34.66	33.65

Source : Gas Malaysia Berhad, Bursa Malaysia

**Oversupply concerns overplayed with supply-demand dynamics appears to be in equilibrium.** We now believe concerns over signs of oversupply have been overplayed, considering that capacity expansion of the four players under our coverage is expected to be delayed and staggered. Kossan's 5.5b pieces capacity is only expected to be gradually ramped up starting from 3Q and 4Q 2019. Top Glove's planned capacity has been scaled back and it only expects effective 2.6b pieces new capacity by end 2019. Hartalega's new capacity is estimated at 4.0b pieces in 2019. If we aggregate these numbers up, the total new capacity is only about 11.6b pieces or 15.5b pieces if grossed up (assuming all the four listed players under our coverage account for an estimated average 75% of total production in Malaysia) compared to an estimated demand of 17.5b pieces (if we take global demand of 270b pieces of gloves and assuming a 10% growth, new incremental demand is expected at 27b pieces and Malaysia accounts for 65% of market share globally), the supply-demand dynamics appears to be in equilibrium. Furthermore, most glove manufacturers can only run at an average maximum utilisation rate of 90% due to required downtime for maintenance while industry capacity expansions are only coming in progressively over the next two years. We also believe that players are pro-active in carrying out measures having experienced various cycles of oversupply thus minimising the risk.

**Estimated incoming capacity indicating equilibrium supply-demand of rubber gloves**

	Top Glove	Supermax	Kossan	Hartalega	Total
Estimated capacity in start CY2019 (bn pieces)	60.5	23.9	26.5	31.2	142.1
Estimated new capacity	2.6^	2.0	3.0	4.0	11.6
Total estimated capacity by end CY2019	63.1	26.9	29.5	36.0	153.7
	Top Glove	Supermax	Kossan	Hartalega	Total
Estimated capacity in start of CY2020 (bn pieces)	63.1	26.9	29.5	36.0	155.5
Estimated new capacity	5.0*	3.0	4.0	4.6	16.6
Total estimated capacity by end CY2020	68.1	28.9	33.5	40.6	172.1

**Estimated new supply from Malaysia and new world demand in 2019**

(a) Estimated world demand (b pieces)	270.0b
(b) Estimated new demand growth = 10%	27.0b
(c) Top four (Kossan, Supermax, Top Glove and Hartalega) new incremental net capacity increase in CY19	11.6
(d) Malaysia accounts for 65% world market share and new demand = (b) x 65%	17.5
(e) Total estimated of new supply in Malaysia (assumption : Top four accounts for an estimated 75% to total production in Malaysia)	15.5

**Estimated new supply from Malaysia and new world demand in 2020**

(a) Estimated world demand (b pieces)	297.0b
(b) Estimated new demand = 10% growth	29.7b
(c) Top four (Kossan, Supermax, Top Glove and Hartalega) new incremental net capacity increase in CY20	16.6
(d) Malaysia accounts for 65% world market share and new demand = (b) x 65%	19.3
(e) Total estimated of new supply in Malaysia (assumption: Top four accounts for an estimated 75% to total production)	22.1

Source: Companies, Kenanga Research

^planned capacity is 5.4b pieces, effective is 2.6b pieces

\*planned capacity is 17.4b pieces, effective is 5.0b pieces

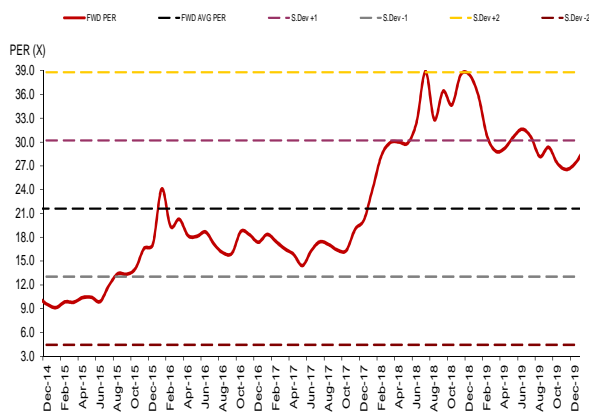
02 January 2020

### Rubber Gloves

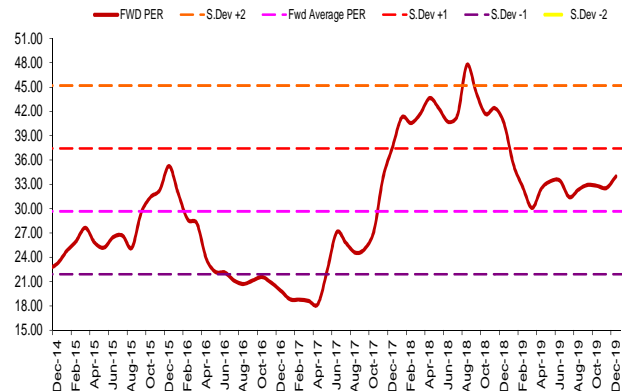
Company	Target Price (RM)	Valuation basis
Kossan Rubber	5.25	based on 25.5x CY20E EPS (+1.0SD above 5-year historical forward mean)
Hartalega	6.00	based on 36x FY21 EPS (at +1.0SD above 5-year historical forward mean)
Top Glove	4.25	based on 25.5x CY20E EPS (+1.0SD above 5-year historical forward mean)
Supermax	1.75	based on 17.5x CY20E EPS (at +1.0SD above its historical forward mean)

Source: Companies, Kenanga Research

### Top Glove - Forward PER

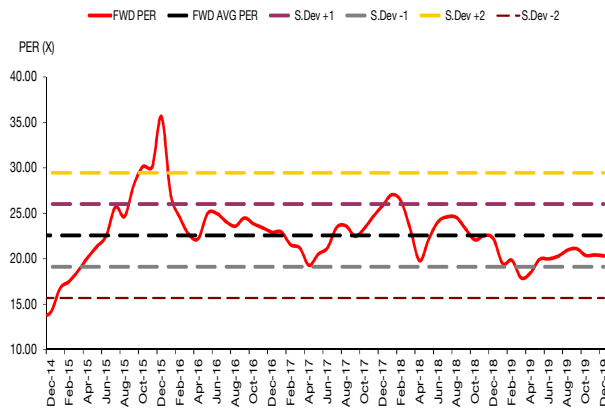


### Hartalega - Forward PER

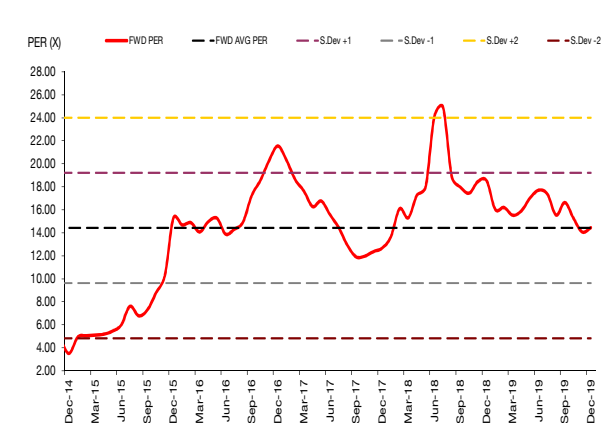


Source: Bloomberg, Kenanga Research

### Kossan - Forward PER



### Supermax - Forward PER



Source: Bloomberg, Kenanga Research

02 January 2020

### Peer Comparison

Name	Price @ 20/12/19 (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div Yld (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.		
RUBBER GLOVES																	
HARTALEGA HOLDINGS BHD	5.51	18585.8	Y	03/2020	3.7	6.2	11.6	6.7	39.9	35.7	33.4	8.1	7.3	20.3	1.3	6.00	OP
KOSSAN RUBBER INDUSTRIES	4.18	5346.0	Y	12/2019	1.8	11.1	13.8	15.2	26.6	23.4	20.3	4.1	3.6	15.4	1.4	5.25	OP
SUPERMAX CORP BHD	1.40	1820.2	Y	06/2020	2.8	6.0	4.1	6.3	15.0	14.4	13.5	1.7	1.6	11.1	2.9	1.75	OP
TOP GLOVE CORP BHD	4.81	12312.7	Y	08/2020	6.9	2.6	11.0	7.5	33.0	29.8	27.7	5.1	4.5	15.1	1.6	4.25	UP

Source: Bloomberg, Kenanga Research

The rest of the page is intentionally left blank

02 January 2020

### Stock Ratings are defined as follows:

#### Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

#### Sector Recommendations\*\*\*

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

**\*\*\*Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

---

This document has been prepared for general circulation based on information obtained from sources believed to be reliable but we do not make any representations as to its accuracy or completeness. Any recommendation contained in this document does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may read this document. This document is for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees. Kenanga Investment Bank Berhad accepts no liability whatsoever for any direct or consequential loss arising from any use of this document or any solicitations of an offer to buy or sell any securities. Kenanga Investment Bank Berhad and its associates, their directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein from time to time in the open market or otherwise, and may receive brokerage fees or act as principal or agent in dealings with respect to these companies.

---

Published and printed by:

#### **KENANGA INVESTMENT BANK BERHAD (15678-H)**

Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia

Telephone: (603) 2172 0880 Website: [www.kenanga.com.my](http://www.kenanga.com.my) Email: [research@kenanga.com.my](mailto:research@kenanga.com.my)

