Gloves

UNDERWEIGHT
↔

Clearer Picture of "How Bad is Bad"; Consolidation

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We reiterate our UNDERWEIGHT rating on the sector. Against our expectations, there was an upside surprise from one player in terms of a narrower loss, but glove makers' 1QCY23 results were undeniably still in a sea of red. The sector will continue to grapple with subdued ASP, rising costs and low plant utilisation amidst intense competition especially from Chinese producers over the near term. However, we take note of local players decommissioning their older production facilities which could take some supply pressures off the sector. Industry consolidation should bring back more rational competition and hopefully stop the bleeding of the players. Consequently, we raise our valuations across the board by applying a smaller discount to the sector's average historical PBV. We upgrade our call on SUPERMX (MP; TP: RM0.96) from UP, while maintaining UP for HART (UP; TP: RM1.90), TOPGLOV (UP; TP: RM0.90) and KOSSAN (UP; TP: RM1.28).

A sea of red in 1QCY23, but slight sequential improvement. Glove players dipped into their second consecutive quarterly losses as reported in the recently concluded 1QCY23 results season. However, there was a slight sequential improvement with 25%/25%/50% of results coming above/within/below our forecasts vs. all players coming in below both our and consensus forecasts in the previous 4QCY22 result season. Out of the four companies under our coverage, one beat our forecasts (HARTA), two disappointed (KOSSAN and TOPGLOV) and one came in within (SUPERMX).

Generally, all players continue to be hit by: (i) excess capacity leading to reluctance of customers to commit sizeable orders and holding substantial stocks on expectations of further price decline, (ii) margin erosion as costs remains elevated including energy and labour costs against falling average selling price (ASP) of USD20/1,000 pieces vs. cost of USD21/1,000 pieces), and (iii) reduced economies of scale arising from volume that is less than optimum, particularly, due to poor cost absorption.

The recent round of results reported by glove makers suggested that players are likely to continue to face a challenging and competitive business landscape due to elevated costs, subdued average selling price and massive capacity leading to suppressed industry utilization rate. As gathered from our channel checks (most players are still unable to raise ASP for shipments in April and May), players believe selling prices have bottomed out (at USD20/1,000 pieces which is our FY24 assumption) and will attempt to raise prices in FY24.However, mindful that the prospect of raising ASP is challenging due to the current massive overcapacity situation, with only a handful of customers agreeing thus far. Separately, taking stock, players have received mixed response in terms of customer inventory levels. Some customers are still stuck with high inventories while others are beginning to slowly restock. Generally, there is no urgency for buyers to place sizeable orders or hold substantial stocks as supply is plentiful and readily available. Case in point, buyers can turn to Chinese manufacturers which are still selling below USD20/1,000 pieces, at USD17/1,000 pieces. Any attempt to raise ASP could cause a reduction in volume sales, in our view.

First sign of industry consolidation. We believe the market is witnessing its first sign of the glove industry transitioning into a rationalisation and consolidation phase amidst the massive industry over-capacity. Indications are pointing towards an improvement in supply-demand equilibrium as players take the opportunity to shut down older plants or productions lines that are no longer efficient and speed up the industry consolidation.Specifically, HARTA is decommissioning its Bestari Jaya (BJ) production facility, and consolidating operations at its Next Generation Integrated Glove Manufacturing Complex (NGC) in Sepang. BJ consists of 4 production plants with 40 production lines or 13b pieces per annum. The decommissioning will reduce its production capacity by 30% to 31b pieces per annum and is expected to be completed by end-2023. Similarly, TOPGLOV is decommissioning two plants with estimated 5b pieces of capacity or 4% of its 100b installed capacity.On the other hand, Supermax has decommission 3 older plants, taking out an estimated 3b pieces per annum from its total capacity.

Upping TPs, narrow discount to sector valuation on lower-than-expected oversupply. Citing the first sign of industry consolidation towards improvement in supply-demand equilibrium, we now apply a smaller discount to the sector's average historical PBV. We are now attaching a 20%-45%discount compared to 50%-60% previously to the sector's average of 1.7x charted during previous downturns in 2008-2011 and 2014-2015 due to the faster-than-expected industry rationalisation. Our ratings are as follows (see page 2): HART (UP↔; TP: RM1.90↑), TOPGLOV (UP↔; TP: RM0.90↑), KOSSAN (UP↔; TP: RM1.28↑) and SUPERMX (MP↑; TP: RM0.96↑).

Oversupply to persist but less acute than we previously forecast. We expect the operating environment to continue to remain challenging in subsequent quarters being plagued by massive oversupply. Nevertheless, we expect the oversupply situation to be less acute and gradually improve following signs of players culling production capacity via decommissioning of selective plants.

Based on our estimates, the demand-supply situation will only start to head towards equilibrium in 2025 when there is virtually no more new capacity coming onstream while the global demand for gloves continues to rise by 15% per annum underpinned by rising hygiene awareness. MARGMA projects 12%-15% growth in the global demand for rubber gloves annually from 2023, following an estimated 19% contraction to 399b pieces in 2022. It believes the supply-demand equilibrium may return in 6-9 months. However, we beg to differ, expecting the overcapacity situation to persist at least over the next 12 months. We project the demand for gloves to rise by 15% in 2023, which is consistent with MARGMA's forecast. On the supply side, we are now factoring a reduction of 21b pieces of gloves in the system by end FY23. This will result in the excess capacity rising by 4% to 115b pieces (instead of rising by 22% or 137b as previously forecast) from 112b pieces in 2022. Despite the improvement, the overcapacity still persist which means low prices and depressed plant utilisation will continue to plague the industry in 2023.

Our 2023 forecasts assume: (i) an ASP per 1,000 pieces of USD20, translating to an estimated 10% decline over 2022, and (ii) an average plant utilisation of 50% vs. an estimated 60% in 2022.

In the meantime, we do not have any top pick for the sector.

Quarterly Results Performance

	1QCY23						4QCY22					
	KENANGA			CONSENSUS			KENANGA			CONSENSUS		
	Above	Within	Below	Above	Within	Below	Above	Within	Below	Above	Within	Below
Hartalega	1					1			1			1
Supermax		1				1			1			1
Kossan			1			1			1			1
Top Glove^			1			1			1			1
Total	**1**	**1**	**2**	**0**	**0**	**4**	**0**	**0**	**4**	**0**	**0**	**4**
Total (%)	**25**	**25**	**50**	**0**	**0**	**100**	**0**	**0**	**100**	**0**	**0**	**100**

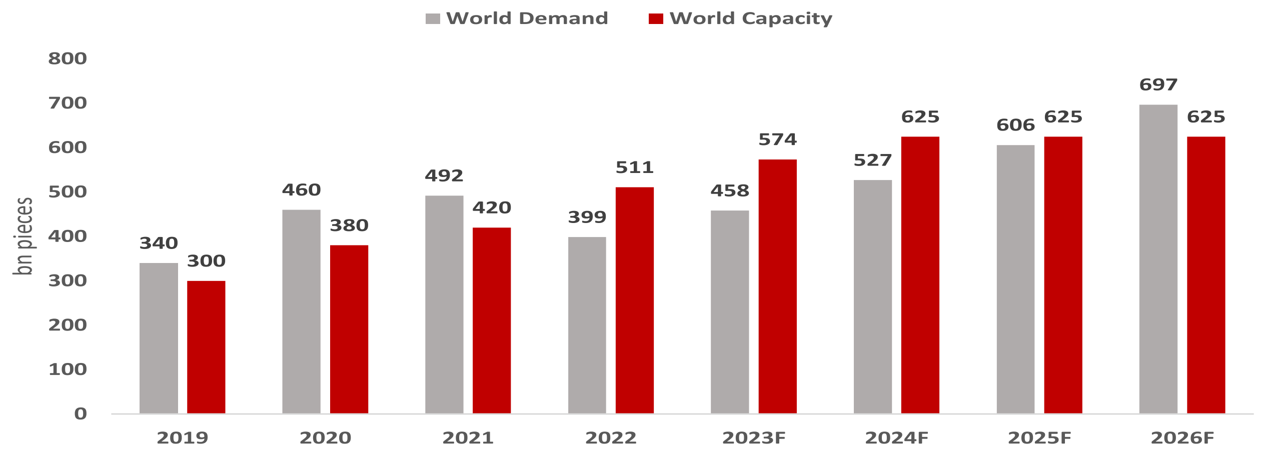
Source: Kenanga Research, Companies quarterly results,^FYE Aug – 2QFY23 vs 1QFY23

Changes in Valuation Basis, TPs and Recommendations

Company	FY24 PBV (x)			TP (RM)			Recommendation		
	After	Before	Chg	After	Before	Chg (%)	After	Before	Chg
HARTA	1.4	0.9	↑	1.90	1.30	+46	UP	UP	↔
TOPGLOV	1.4	0.9	↑	0.90	0.58	+55	UP	UP	↔
KOSSAN	0.9	0.6	↑	1.28	0.85	+51	UP	UP	↔
SUPERMAX	0.6	0.4	↑	0.96	0.70	+26	MP	UP	↑

Source: Kenanga Research

Estimated Global Demand/Supply - Excess Supply over CY22-CY24



Source: Kenanga Research

Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net. Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
HARTALEGA HOLDINGS BHD	UP	2.30	1.90	-17%	7,860	Y	03/2023	(2.4)	0.8	-138%	-68%	NM	298.5	1.7	-1.8%	0.0	0.0%
KOSSAN RUBBER INDUSTRIES	UP	1.43	1.28	-10%	3,649	Y	12/2023	(3.0)	0.9	-149%	-71%	NM	163.3	1.0	-2.0%	0.0	0.0%
SUPERMAX CORP BHD	MP	0.925	0.960	4%	2,383	Y	06/2023	(6.4)	0.9	-124%	-86%	NM	103.6	0.6	-3.7%	4.0	4.3%
TOP GLOVE CORP BHD	UP	1.11	0.900	-19%	8,889	Y	08/2023	(5.5)	0.5	-291%	-91%	NM	220.4	1.8	-8.3%	0.0	0.0%

Source: Kenanga Research

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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.***

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