# Rubber Gloves

## ASP to Stay Elevated

**OVERWEIGHT**

↔

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**Maintain OVERWEIGHT. Rubber glove stocks under our coverage have gone through share price volatility over the past months on concerns that investors are looking at earnings beyond FY21. Based on our analysis presented in this report, we can conclude that: (i) ASP is going to be stubbornly high at least till mid 2021 which supports exponential QoQ earnings growth over the next few quarters, (ii) tight supply situation following nitrile raw material and glove formers shortage will lead to longer production lead time, and (iii) 2020 to 2022 estimated incoming capacity are indicating demand to continue outpacing supply. All in, we are excited with the sector prospects over the next few quarters due to supply tightness amid strong demand. Specifically, industry trend of rising weekly and monthly ASPs is expected to boost bottom-lines. Amplifying the growth are restocking and inventory-building activities creating a supernormal demand spurt leading to acute supply shortage, due to the prolonged pandemic. We have OUTPERFORM calls on HARTA (OP; TP: RM26.22); KOSSAN (OP; TP: RM17.10) SUPERMX (OP; TP: RM12.75) and TOPGLOV (OP; TP: RM10.68). Our Top Pick for the sector is HARTA (OP; TP: RM26.22) since ASP catchup is expected to be reflected in 3Q 2020 onwards implying strong earnings growth.**

**ASPs still rising and prospects are looking bright.** We highlight that industry ASP for months of Sept to Dec is rising monthly by between 10% to 30% indicating supply tightness have further propelled ASP higher. We highlight that TOPGLOV's ASP for months of Sept/Oct/Nov is higher by 30%/30%/15% m-o-m further indicating supply tightness. With a diverse customer base, we expect TOPLGOV to have better pricing power and hence potentially above-average industry prices. We expect hike in raw material prices due to supply constraints which flows to higher ASPs. We do not expect supply to flood the market at least in the first three quarters of 2021 despite growing concern amongst investors that a number of Malaysian listed companies' have announced new ventures into the gloves manufacturing segment.

**2020 to 2022 estimated incoming capacity indicates demand > supply keeping ASP high.** We have done an analysis to quash any concerns of oversupply. In anticipation of higher demand due to the pandemic, stock piling and new users following the pandemic, players are raising capacities to meet the surging demand. Our analysis (see table overleaf) suggests that acute supply shortage and supernormal demand could persist over the next two years. Interestingly, players are getting orders for new users that include airlines, restaurants, retail apparel chains and hotel operators. If we look at the capacity expansion numbers in isolation, it looks overwhelming. Juxtaposed against the annual demand growth and new pandemic-led demand, the additional capacity is not a concern.

**Limited raw material and glove formers to further cap oversupply concerns and underpin sustained high ASPs.** We expect hike in raw material prices due to supply constraints to present a potential potent combination for higher ASPs. We do not expect supply to flood the market at least in the first three quarters of 2021 despite growing concern amongst investors that a number of Malaysian listed companies' have announced new ventures into the gloves manufacturing segment. Furthermore, the typical timeline to complete a plant takes 12-15 months from land acquisition to obtaining approvals in terms of audit checks by clients and regulatory approvals to commissioning the first line.

**Nitrile gloves' market share to gain further momentum with potential 30% growth.** Based on our analysis, we expect nitrile gloves to continue growing and expropriating market share from latex gloves. The growth in nitrile segment is evident. For illustration purposes, going forward, assuming nitrile:latex breakdown of 80:20 (currently at 67:37) and based on estimated global demand of 324b pieces in 2020 (forecast for 2019 is 300b pieces and assuming 8% growth rate in 2020), this implies nitrile growth rate of 20% or an additional 42b pieces from switching to nitrile gloves.

**HARTA (OP; TP: RM26.22).** We expect Hartalega's ASP to play catch up and expect subsequent quarterly earnings to rise exponentially. We like Hartalega for: (i) its solid management, (ii) constantly evolving via innovative products development, and (iii) its booming nitrile gloves segment.

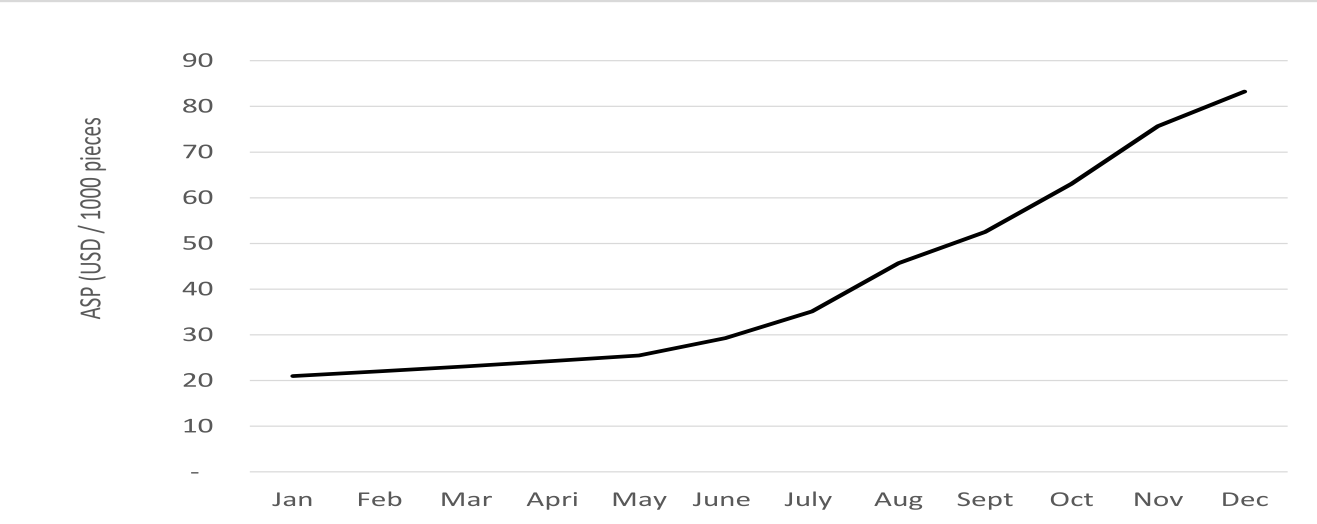
**TOPGLOV (OP; TP; RM10.68).** We highlight that TOPGLOV's ASP for months of Sept/Oct/Nov is higher by 30%/30%/15% m-o-m further indicating supply tightness. With a diverse customer base, we expect TOPLGOV to have better pricing power and hence potentially higher-than-expected industry average prices.

### KEY POINTS

**ASPs still rising.** We highlight that industry ASP for months of Sept to Dec is higher by between 10% to 30% indicating supply tightness have further propelled ASP higher. TOPGLOV's ASP for months of Sept/Oct/Nov is higher by 30%/30%/15% m-o-m further indicating supply tightness. With a diverse customer base, we expect TOPLGOV to command pricing power and hence potentially above-average industry prices. The Group's monthly order-book has seen a significant rise of about 150% from pre-COVID days while lead time (delivery) has gone up from about 40 days to as high as c.400 days presently. Management is optimistic on the outlook ahead and reiterated that the glove industry's prospect remains promising. With a diverse customer base, we expect TOPLGOV to have better pricing power and hence potentially higher-than-expected industry average prices. Elsewhere, Supermax is expected to gain from higher margins from both its gloves manufacturing and distribution. We expect higher margins going forward due to higher product mix skewed towards OBM distribution which accounts for 95% compared to 70% pre-Covid-19 which we believe had caught us as well as the market by surprise at a time when supply is tight due to aggressive stockpiling of critical medical supplies including gloves. Glove players are getting enquiries from foreign government agencies, non-government organisations, retailers and restaurants chains. Amplifying the pent-up demand, buyers are paying between 10% to 50% deposits in advance to secure glove supply and timely delivery. Typically, the current supply-demand dynamics has led to lead time of 12 months currently compared to 10 months, and order-books are filled up to between Mar 2021 and June 2021. This led to higher utilisation rate of >95% as compared to pre-COVID-19 level of 80-85%. Some players are experiencing fast inventory depletion from the normal 4 months to within 6 weeks. Generally, players expect the heightened demand to continue for the next 1 to 1.5 years. Despite players ramping up supply, we believe the gradual staggered incoming capacity is likely to keep ASPs elevated over the medium term.

**Raw material and glove formers constrain to cap oversupply concerns and underpin sustained high ASPs.** We expect hike in raw material prices due to supply constraints to keep ASPs elevated while maintaining margins. We do not expect supply to flood the market at least in the first three quarters of 2021 despite growing concern amongst investors that a number of Malaysian listed companies' have announced new ventures into the gloves manufacturing segment. Furthermore, the typical timeline to complete a plant takes 12-15 months from land acquisition to obtaining approvals in terms of audit checks by clients and regulatory approvals to commissioning of first line. Additionally, there is also a severe shortage of nitrile butadiene latex raw material in the market, and we expect this to hamper the new glove makers' expansion plans.

**Industry average ASPs – Accelerating to USD100**




*Source: Various, Kenanga Research*

**Estimated incoming capacity indicating shortage supply till 2022.** We have done an analysis to quash any concerns of oversupply. We highlight that even assuming a 15% demand growth in 2022, supply would be unable to meet demand. In anticipation of higher demand due to the pandemic, stock piling and new users following the pandemic, players are raising capacities to meet the surging demand. Our analysis (see table overleaf) suggests that acute supply and super-normal demand could persist over the next two years. Interestingly, players are getting orders for new users that include airlines, restaurants, retail apparel chains and hotel operators. If we look at the capacity expansion numbers in isolation, it looks overwhelming. Juxtaposed against the annual demand growth and new pandemic-led demand, the additional capacity is not a concern. In fact, the estimated new yearly capacity may not actually start as scheduled and hence the supply shortage will continue to be acute in 2021. Typically, to cater for normal demand, glove makers essentially need to build just one plant per year. However, from channel checks, to cater for this current pandemic-driven demand, two to three plants are required for each glove maker (on average) annually in order to meet the supernormal demand, which take between 12 to 24 months to complete. Hence, we conclude that ASP tightness will continue going into 2021. We highlight that rumours of a player in China ramping up capacity by 30b pieces over 2-3 years appears absurd as it typically takes 8 to 10 years to build such capacity.

**Estimated incoming capacity indicating potential acute supply shortage**

| | Top Glove | Supermax | Kossan | Hartalega | Total |
|---|---|---|---|---|---|
| Estimated capacity start of CY2020 (bn pieces) | 71.5 | 21.8 | 28 | 36.6 | 157.9 |
| Estimated new capacity | 17.6 | 4.4 | 3 | 2.8 | 27.8 |
| Total estimated capacity by end CY2020 | 89.1 | 26.2 | 31 | 39.4 | 185.7 |
| | Top Glove | Supermax | Kossan | Hartalega | Total |
| Estimated capacity start of CY2021 (bn pieces) | 89.1 | 26.2 | 31 | 39.4 | 185.7 |
| Estimated new capacity | 15.4 | 6.0 | 4.5 | 3.8 | 29.7 |
| Total estimated capacity by end CY2021 | 104.5 | 32.2 | 35.5 | 43.2 | 215.4 |
| | Top Glove | Supermax | Kossan | Hartalega | Total |
| Estimated capacity start of CY2022 (bn pieces) | 104.5 | 32.2 | 35.5 | 43.2 | 215.4 |
| Estimated new capacity | 16.1 | 6.0 | 4.0 | 5.0 | 31.1 |
| Total estimated capacity by end CY2022 | 120.6 | 38.2 | 39.5 | 48.2 | 246.5 |

| | |
|---|---|
| **Estimated new supply from Malaysia and new world demand in 2020 (demand > supply)** | |
| (a) Estimated world demand (b pieces) | 360b |
| (b) Estimated new global demand growth [20% = pandemic demand (10%) + normal demand (10%)] | 60b |
| (c)Top four (Kossan, Supermax, Top Glove and Hartalega) incremental net capacity increase in CY20 | 27.8 |
| (d) Malaysia accounts for 65% world market share and new demand = (b) x 65% | 39 |
| (e) Total estimated of new supply in Malaysia (assumption: Top four accounts for an estimated 80% to total production in Malaysia) = (C) / 80% | 35 |
| **Estimated new supply from Malaysia and new world demand in 2021 (demand > supply)** | |
| (a) Estimated world demand (b pieces) | 432b |
| (b) Estimated new global demand growth [20% = pandemic demand (10%) + normal demand (10%)] | 72b |
| (c)Top four (Kossan, Supermax, Top Glove and Hartalega) new incremental net capacity increase in CY21 | 29.7 |
| (d) Malaysia accounts for 65% world market share and new demand = (b) x 65% | 47 |
| (e) Total estimated of new supply in Malaysia (assumption: Top four accounts for an estimated 80% to total production) = (C) / 80% | 37.1 |
| **Estimated new supply from Malaysia and new world demand in 2022 (demand > supply)** | |
| (a) Estimated world demand (b pieces) | 496.8b |
| (b) Estimated new global demand growth [15%] | 64.8b |
| (c)Top four (Kossan, Supermax, Top Glove and Hartalega) new incremental net capacity increase in CY22 | 31.1 |
| (d) Malaysia accounts for 65% world market share and new demand = (b) x 65% | 42 |
| (e) Total estimated of new supply in Malaysia (assumption: Top four accounts for an estimated 80% to total production) = (C) / 80% | 20.2 |

*Source: Companies, Kenanga Research*

**Structural changes to global demand and users for examination rubber gloves.** Incremental volume growth is expected from new users of examination rubber gloves including nitrile and latex based. Typically, housewives don rubber gloves to do their washing and cleaning, and sometimes even cooking. Maids use them, as do hospital janitors who have to handle medical waste. At Japanese restaurants, cooks behind sushi counters maintain standards of hygiene by wearing rubber gloves as they prepare the food. Those who have an allergic reaction to latex can opt for nitrile gloves as an alternative. With selling price per piece averaging between USD0.06 to USD0.10 per piece, medical grade examination rubber gloves provide the cheapest form of health protection.

**ASPs sensitivity to our earnings model, ASP moving towards USD100/1,000 pieces.** Overall, earnings visibility in the sector looks reasonably good for FY21 based on lengthened demand lead times and ASP momentum moving into USD100/1,000 pieces rendering prospective earnings in the sector too good to ignore. Although order-books and lead times suggest that FY22 demand will remain strong, while clarity on ASP diminishes, we are sold on the point that rubber glove makers are benefitting immensely from increased demand that is sustainable - a step up change that is structural out of heightened hygiene awareness that extends beyond the healthcare community. On this point alone, we note that there is upside risk to our earnings projection for FY22, as we have reflected conservative assumptions of firstly, that ASP **would normalise from USD100/1,000 pieces to USD40/1,000 pieces (on easing of supply bottlenecks) and secondly, lagging costs of production which hitherto has been fairly contained would likely catch up, namely labour (10% of production cost) and raw materials (45% of production cost). In our view, ASP USD40/1,000 pieces implying USD0.04/piece which is reasonably low.**

**TOP GLOVE - Earnings sensitivity and Target Price**

| FYE Aug | FY21E | FY22E |
|---|---|---|
| Current ASP assumption (USD/1000 pieces) | 55.0 | 40.0 |
| Current Net profit (RM) | 6.6b | 4.1b |
| Current EPS (sen) | 81.5 | 50.1 |
| PER at shar price of RM8.40 | 10.3 | 16.0 |
| Current TP is RM10.68 based on 15x CY21E (at -0.5SD below 5-year historical forward mean). | | |
| Assuming ASP (USD/1000 pieces) | 70 | 35 |
| Net profit (RM) | 11b | 3.8b |
| EPS (sen) | 135.0 | 46.4 |
| PER at share price of RM8.40 | 6.2 | 18.1 |
| Illustration TP : assuming ASP USD70/USD40 FY21/FY22 and CY21 EPS 105.5 | | |
| TP at (-0.5 SD below 5-yr historical forward average 15x) RM15.82 | | |
| TP at (-1.0 SD below 5-yr historical forward average 10x) RM10.55 | | |

*Source: Kenanga Research*

**HARTALEGA - Earnings sensitivity and Target Price**

| FYE Mar | FY21E | FY22E | FY23E |
|---|---|---|---|
| Current ASP (USD/1000 pieces) | 41 | 43 | NA |
| Current Net profit (RM) | 1.9b | 2.5b | NA |
| Current EPS (sen) | 58.4 | 72.5 | NA |
| PER (x) at share price of RM16.20 | 27.7 | 22.3 | NA |
| Current TP is RM26.22 based on 38x CY21E EPS (at <+1.0SD above 5-year historical forward mean) | | | |
| Assuming ASP (USD/1000 pieces) | 50 | 60 | 35 |
| Net profit (RM) | 2.6b | 5.0b | 2.3b |
| EPS (sen) | 76.4 | 145.9 | 67.7 |
| PER (x) at share price of RM16.20 | 21.2 | 11.1 | 23.9 |
| Illustration TP assuming ASP USD50/1000 and USD60 in FY21E/FY22E and CY21 EPS 138.1 | | | |
| TP at (-0.5 SD below 5-yr historical forward average 20x) | | RM27.63 | |
| TP at (-1.0 SD below 5-yr historical forward average 16x) | | RM22.10 | |

*Source: Kenanga Research*

**KOSSAN - Earnings sensitivity and Target Price**

| FYE Dec | FY20E | FY21E | FY22E |
|---|---|---|---|
| Current ASP (USD/1000 pieces) | 32 | 33 | NA |
| Current Net profit (RM) | 682m | 812m | NA |
| Current EPS (sen) | 53.3 | 63.5 | NA |
| PER (x) at current shar price | 25.3 | 21.3 | NA |
| TP is RM17.10 based on 27x FY21E EPS (at +1.0SD above 5-year historical forward mean). | | | |
| Assuming ASP (USD/1000 pieces) | 45 | 45 | 35 |
| Net profit (RM) | 1000m | 1200m | 1052m |
| EPS (sen) | 81.4 | 94.5 | 82.3 |
| PER (x) at current share price | 16.6 | 14.3 | 16 |
| Illustration TP assuming ASP USD45 | | | |
| TP at (-0.5 SD below 5-yr historical forward average 17x) based on FY21 EPS | | RM16.10 | |
| TP at (-1.0 SD below 5-yr historical forward average 13x) based on FY21 EPS | | RM12.30 | |

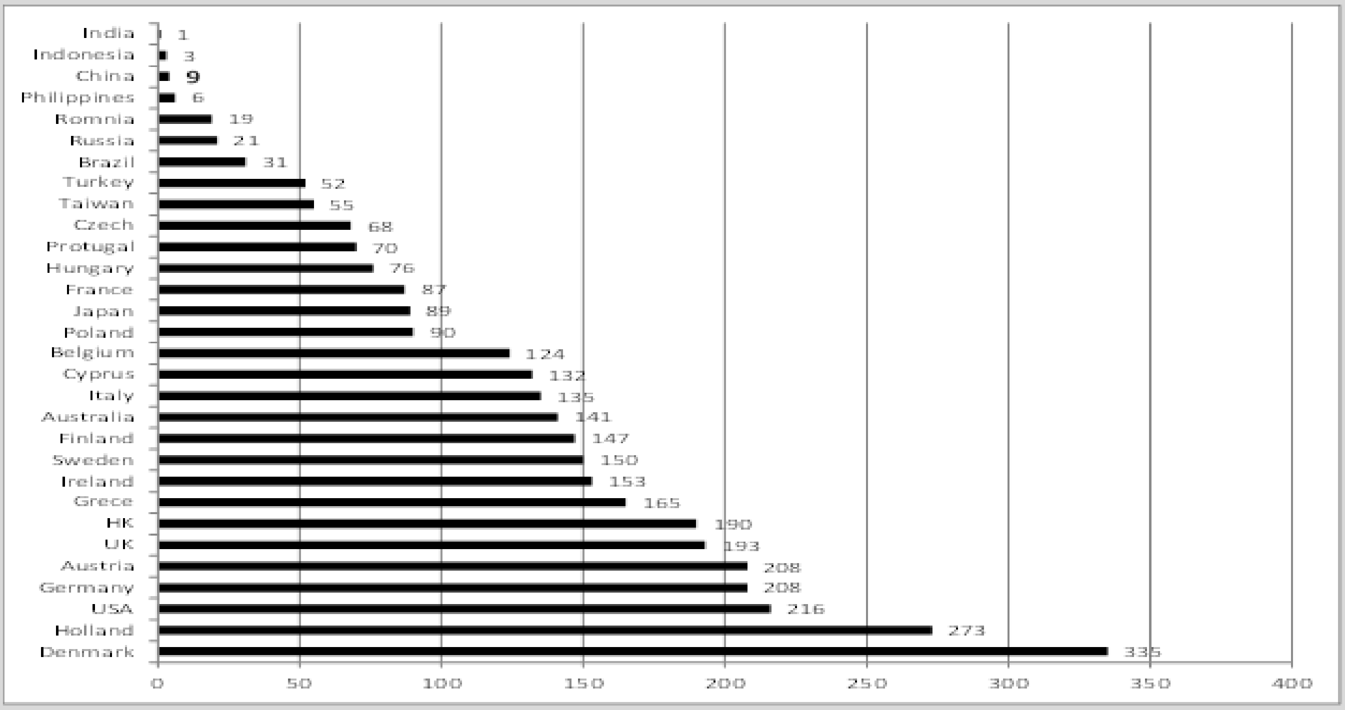
*Source: Kenanga Research*

| SUPERMAX - Earnings sensitivity and Target Price | | | |
|---|---|---|---|
| **FYE June** | **FY21E** | **FY22E** | **FY23E** |
| Current ASP (USD/1000 pieces) | 44 | 43 | NA |
| Current Net profit (RM) | 1.6b | 1.6b | NA |
| Current EPS (sen) | 59.9 | 62.3 | NA |
| PER (x) at share price RM8.40 | 14.0 | 13.5 | NA |
| TP is RM12.75 based on 20.8x CY21 EPS) (at slightly below +2.0SD above the 5-year historical forward mean) | | | |
| Assuming ASP (USD/1000 pieces) | 70 | 60 | 35 |
| Net profit (RM) | 2.9b | 2.4b | 1.5b |
| EPS (sen) | 110 | 87.4 | 58.0 |
| PER (x) at share price RM8.40 | 7.6 | 9.6 | 14.5 |
| Illustration TP assuming ASP USD70/USD60 in FY21/FY22 and CY21 EPS of 98.7 sen | | | |
| TP at (5-yr historical forward average 12x) based on CY21 EPS | | RM11.85 | |
| TP at (-0.5 SD below 5-yr historical forward average 10x) based on CY21 EPS | | RM9.86 | |

*Source: Kenanga Research*

**China and low user per capita countries are potential high growth markets.** We expect gloves consumption per capita in China to surge sharply following the COVID-19 experience. For illustration purposes, assuming a population of 1.4b and conservative 30 gloves per capita (from currently 9 – please refer to chart overleaf - compared to developed western countries which averaged 200 pieces per capita), this implies a massive 42b piece (from currently 2.8bn pieces) of rubber gloves consumption in China annually. Hence, any new supply from the Chinese players could be absorbed domestically.

**Gloves per capita consumption**




*Source: Hartalega, various, Kenanga Research*

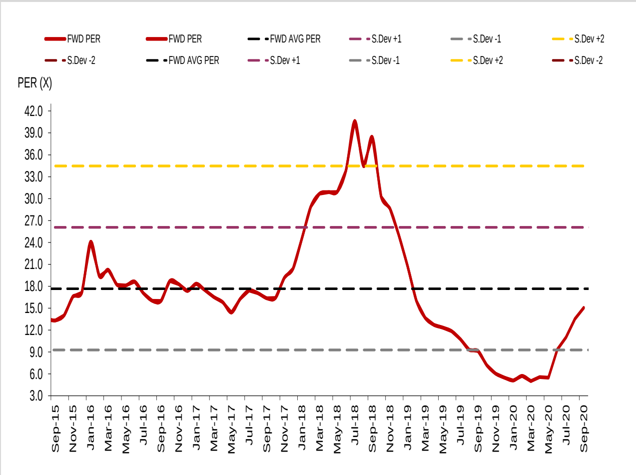
**TOPGLOV (OP; TP: RM10.68).** We highlight that industry ASP for months of Sept to Dec is now higher by between 10% to 20% indicating supply tightness have further propelled ASP higher. We highlight that TOPGLOV's ASP for months of Sept/Oct/Nov is higher by 30%/30%/15% m-o-m further indicating supply tightness. With a diverse customer base, we expect TOPLGOV to have better pricing power and hence potentially higher-than-expected industry average prices. Its merits are: (i) a strong management, (ii) resilient earnings base due to its pricing power and sheer capacity size in the industry, and (iii) solid earnings growth averaging >100% in FY21 compared to PER of 10x.

**HARTA (OP; TP: RM26.22).** YTD, the stock is up >100%, and looking at the previous up-cycle when the stock rose 200%, this indicates potential further upside because of the quantum leap in earnings and hence growth over the next few quarters. We like Hartalega for: (i) its solid management, (ii) constantly evolving via innovative products development, and (iii) its booming nitrile gloves segment.

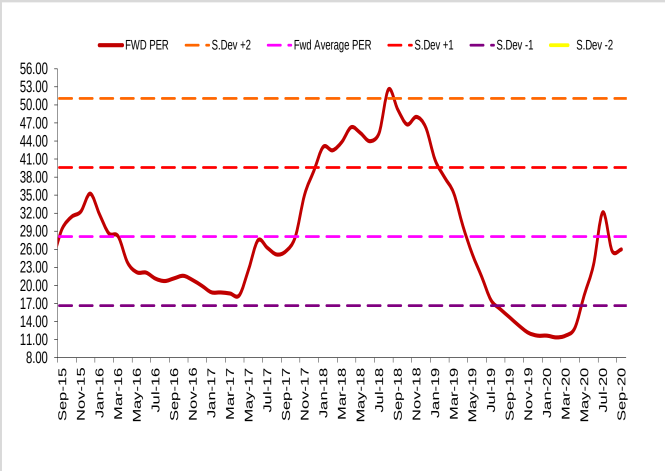
**SUPERMAX (OP; TP: RM12.75). Dual-stream incomes from manufacturing and distribution.** Supermax is expected to gain from higher margins from both its gloves manufacturing and distribution divisions. We expect higher margins going forward due to higher product mix skewed towards OBM distribution which accounts for 95% compared to 70% pre Covid-19 which we believe had caught us as well as the market by surprise at a time when supply is tight due to aggressive stockpiling of critical medical supplies including gloves. Supermax is getting enquiries from foreign government agencies, non-government organizations, retailers and restaurants chains. Amplifying the pent-up demand, buyers are paying between 30% to 50% deposits in advance to secure glove supply and timely delivery.

**KOSSAN (OP; TP: RM17.10).** We are positive on Kossan's prospects over the next few quarters. Management is confident of sustained strong demand at least till end-1QCY21, wringing extra earnings from an additional 10% utilisation from pre-pandemic 85-90% level and margins expansion from four new lines catering to spot customers. However, the lag impact from ASP hike can only be felt in 2H 2020.

**Top Glove - Forward PER**

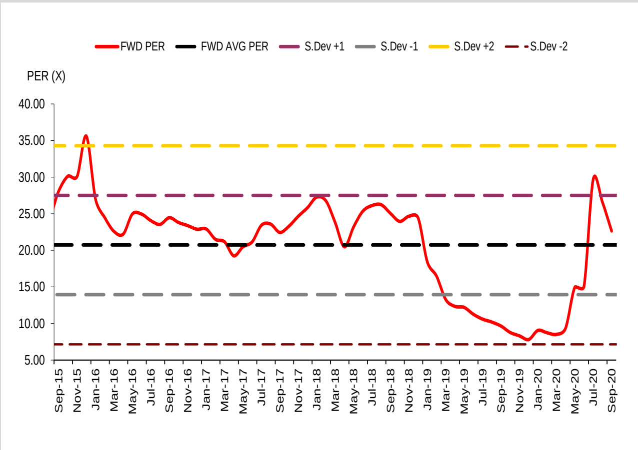



**Hartalega - Forward PER**

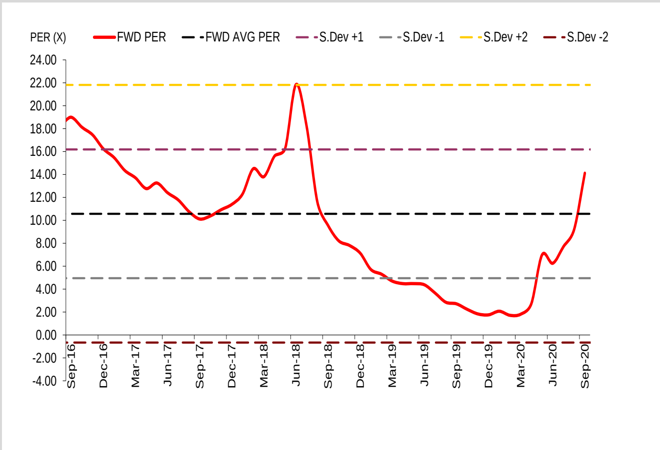



*Source: Bloomberg, Kenanga Research*

**Kossan - Forward PER**




**Supermax - Forward PER**




*Source: Bloomberg, Kenanga Research*

Peer Comparison

| Name | Price (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 | 17.50 | 59,983 | Y | 03/2021 | 115% | 23.4% | 357% | 24.1% | 134.0 | 29.9 | 24.1 | 22.9 | 16.8 | 65% | 1.7% | 26.22 | OP |
| KOSSAN RUBBER INDUSTRIES | 14.62 | 18,698 | Y | 12/2020 | 54% | 21.0% | 203% | 19.0% | 83.2 | 27.4 | 23.0 | 13.1 | 9.4 | 40% | 0.7% | 17.10 | OP |
| SUPERMAX CORP BHD | 8.98 | 23,067 | Y | 06/2021 | 123% | 3.1% | 214% | 4.0% | 47.1 | 15.0 | 14.4 | 15.4 | 9.5 | 79% | 2.7% | 12.75 | OP |
| TOP GLOVE CORP BHD | 8.76 | 71,262 | Y | 08/2021 | 139% | -22% | 257% | -38% | 38.3 | 10.7 | 17.4 | 14.3 | 9.4 | 106% | 4.7% | 10.68 | OP |

*Source: Bloomberg, 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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