Industrials

Malaysia

Malaysia Gloves Sector

NEGATIVE *[Downgrade]*

Not the time for bottom fishing

Analyst

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ASP downturn yet to find bottom; D/G to NEGATIVE

ASP is declining fast and could hit pre-Covid levels by mid-2022 i.e. another -42% from current level of about USD40/k pcs in Sep 21. With the stiff competition from China, we believe the Malaysian glove sector is experiencing a structural change and the oversupply situation could potentially extend longer than the typical downcycle of 6-9 months. A strong balance sheet is hence paramount to surviving the inevitable price war. We D/G the sector to NEGATIVE (from NEUTRAL). We are SELLers for Top Glove, Hartalega and Kossan.

A few issues to contend with

ASP is falling faster than expected. Since May-June 21, industry players have been guiding for a weaker ASP outlook. ASP is expected to decline -8% to -10% MoM (peak: USD130-140/k pcs in early 2021 vs. c. USD40/k pcs in Sep 21) and could return to pre-Covid levels of USD23-24/k pcs by mid-2022, representing a -42% decline from the current level. Rubbing salt into the wound are other issues such as lower utilization rates and additional operating costs on stricter SOPs as well as labour shortage. As such, we expect weaker earnings performance in the coming quarters.

China, a new force that can’t be ignored

The threat from China is real. Aggressive capacity expansion by the Chinese glove makers would likely lead to oversupply by 2023. Already, to seize the market share, the Chinese glove makers are selling their gloves at more attractive pricing in Europe relative to their Malaysian counterparts. According to industry players, the Chinese glove makers are expected to contribute 23% of the world’s glove supply by 2022 (from 16% now) while Malaysia’s market share is expected to shrink to 60% in 2022, from 67%.

D/G Hartalega and Kossan to SELL

We now value the glove players at -1SD of historical mean (-0.5SD before). This is to reflect increasing competition from China glove makers, which presents downside risks to ASPs. We downgrade Hartalega and Kossan to SELLs (from HOLDs) after factoring in the change in valuation basis (for Kossan) and lower ASP assumptions (FY22: -45%; FY23: -21%) that have led to a -1% to -76%% downward revision to earnings. Positively though, the listed glove producers have strong balance sheets and low operating costs, and this will sustain them through this competitive phase.

Stock	Bloomberg	Mkt cap	Rating	Price	TP	Upside	P/E (x)		P/B (x)		Div yld (%)	
	code	(USD'm)		(LC)	(LC)	(%)	21E	22E	21E	22E	21E	22E
Top Glove	TOPG MK	5,461	Sell	2.78	1.68	(37)	4.1	18.1	4.4	2.9	16.3	2.8
Hartalega	HART MK	4,832	Sell	5.89	3.99	(30)	10.3	5.8	6.1	3.1	5.6	10.0
Kossan Rubber	KRI MK	1,433	Sell	2.34	1.86	(19)	2.2	16.0	1.4	1.3	16.1	2.2

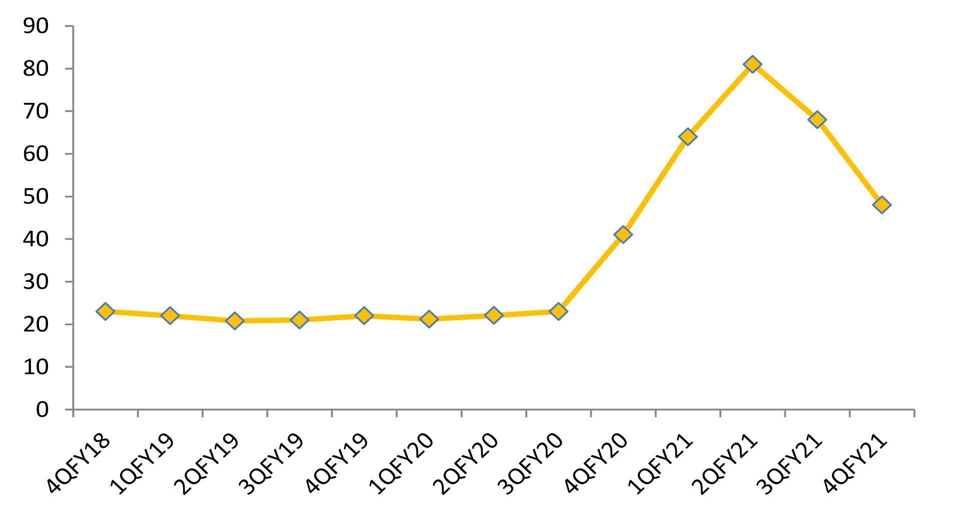
Recent results signal good times has ended

ASP falling faster-than-expected

Top Glove's recent FY8/21 results underlined the challenges faced by the Malaysian glove makers. The company reported a weaker-than-expected 4QFY8/21 dragged by lower sales volume due to the US' ban on its rubber gloves, lower utilization rates due to the lockdowns as well as declining average selling prices (ASP; 4QFY21: -29% QoQ versus 3QFY21: -16% QoQ). While the lower ASP could be due in part to the diversion of its gloves to non-US countries after the US ban, the decline in ASP was also caused by stiffer competition especially from the Chinese counterparts.

Since May/June 21, the two market leaders i.e. Top Glove and Hartalega, have been guiding for a weaker ASP outlook where ASP is expected to decline -8% to -10% MoM. However, ASP seems to be falling quicker than expected and the two market leaders now expect ASP to only stabilize in 1Q22. Top Glove now even expects ASP to return to pre-Covid levels of USD23-24/k pcs by mid-2022 (versus USD130-140/k pcs spot price [highest] in early 2021). This represents a -42% decline from the current ASP of USD40/k pcs in Sep 21.

Top Glove's QoQ blended ASP (USD/kpcs)



Source: Top Glove

Lockdowns have had an impact as well

The Malaysian glove makers are facing other challenges domestically. Since May-June 21, they have been operating under stricter SOPs that lead to lower utilization rates and higher operating costs (Covid-related costs such as test kits and vaccines). Exacerbating the situation was the sudden full lockdown imposed in early July 21 that led to the closure of all glove plants in Selangor. The sudden closures influenced not just business operations but also customers' buying patterns. To reduce the supply risk, some customers have shifted part of their orders to the Chinese glove makers for the first time. Apart from the stricter SOPs and various phases of National Recovery Plan, Malaysian glove makers' production has also been affected by the serious shortage of foreign workers.

As a result, we believe Hartalega and Kossan's superb earnings performance in 1QFY3/22 and 2QFY21 are not sustainable and we expect the upcoming 2QFY3/22 and 3QFY21 results to be weaker QoQ due to declining ASP, lower sales volume and lower utilization rates.

This situation is expected to improve, now that the economy is gradually opening up, and we understand that utilization rates in recent weeks have improved to about 60-70% from 60% in June-July 21. The labour shortage issue will, however, take some time to normalize.

China, a threat that can't be underestimated

Aggressive capacity expansion by the Chinese glove makers could lead to oversupply by 2023. According to industry players, the Chinese glove makers are expected to contribute to 23% of the total share of the world's glove supply by 2022 (from 16% now) while Malaysia's market share is expected to shrink to 60% in 2022 (from 67%). As it stands, the Chinese glove makers are already engaged in a price war to seize market share, selling their gloves at more attractive pricing (below USD30/k pcs) than Malaysian players, in Europe. While it has been argued that the glove quality out of China may not be as high as that of their Malaysian counterparts and that the power outages in China may affect the production there, these issues are likely temporary, in our view.

Valuation and recommendations

Lower ASP assumptions

We lower our ASP assumptions by -45% to USD27/k pcs (from USD49/k pcs) for 2022 and by -21% to USD23/k pcs (from USD29/k pcs) for 2023 while maintaining our ASP assumption of USD73/k pcs for 2021. We lower our FY22/FY23/FY24 earnings forecasts for Hartalega by -1%/-60%/-33% and Kossan's FY21/FY22/FY23 earnings estimates by -1%/-76%/-33% while maintain earnings estimates for Top Glove as we have already incorporated lower ASP assumptions for the company in our report dated 20 Sep 21.

In view of the stiff competition from China, we believe the Malaysian glove sector is experiencing a structural change. Price war is inevitable and could last more than the typical downcycle of 6-9 months. We value the glove players under our coverage at -1SD (instead of -0.5SD) of historical mean. The discount is to reflect the threats (i.e. price war and shrinking market share) arising from the aggressive involvement of China glove makers. We downgrade Hartalega to SELL (from HOLD) with a new MYR3.99/sh TP (from MYR6.74; on an unchanged 19.4x CY23 PER) and Kossan to SELL (from HOLD) with a new target price of MYR1.86/sh (on a lower 17.7x FY23 PER, from 20x or -0.5SD of historical mean). We maintain our SELL call on Top Glove with an unchanged MYR1.68 TP (12.7x CY23 PER).

Gloves: Lower PER (-1SD of historical mean) to reflect the structural change in the glove sector

Companies	Old	PER^		Pre Covid-19 PER (x)*				
	Previous TP (MYR/sh)	-1SD of mean	Stock rating	-1SD	Mean	+1SD	New TP (MYR/Sh)	Stock rating
Top Glove	1.68	12.7	SELL	12.7	18.9	25.1	1.68	SELL
Hartalega	6.74	19.4	HOLD	19.4	28.7	38.1	3.99	SELL
Kossan	3.16	20.0^^	HOLD	17.7	22.2	26.7	1.86	SELL

**between 2014-2018*
^ valuation basis ^^based on -0.5SD of historical mean previoulsy
Source: Maybank KE

Not the time yet for bottom fishing

ASPs have yet to find a bottom, in our view, and as such, we do not think that this is the time to bottom fish glove stocks just yet. Additionally, we expect interest in COVID-related stocks such as gloves to wane as the vaccination rate rises globally. We downgrade the glove sector to NEGATIVE, from NEUTRAL.

We believe strong balance sheets and low operating costs are important factors that will allow glove makers to weather through the downturn and provide some financial cushion to the imminent price war. Fortunately, the glove makers under our coverage i.e. Top Glove, Hartalega and Kossan have accumulated sizeable amounts of cash during the peak cycle and are now in net cash positions. The strong balance sheet should be able to self-fund their capacity expansions for the next few years.

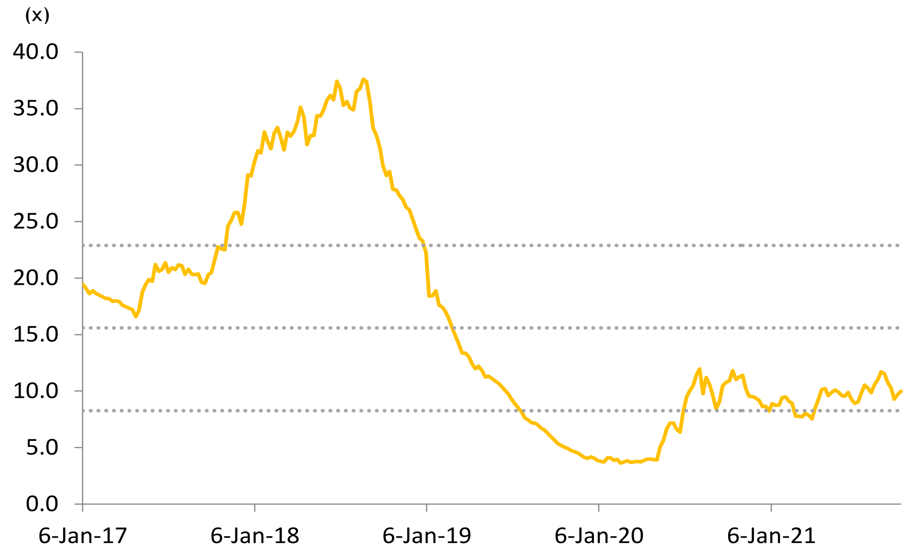
Our concern would be with new entrants that rushed into the glove sector during the peak cycle in end 2020. In order to get their factories ready within very short period, we understand that these new entrants paid premium pricing for their plants, installation works, machineries, raw materials and even staffs; hence, high operating costs, making them less competitive in pricing.

Glove makers under our coverage are in net cash position

	Net cash (MYRm)	Net cash/sh (MYR)
Hartalega	3,083.5	0.90
Kossan	1,637.8	0.64
Top Glove	2,050.0	0.25

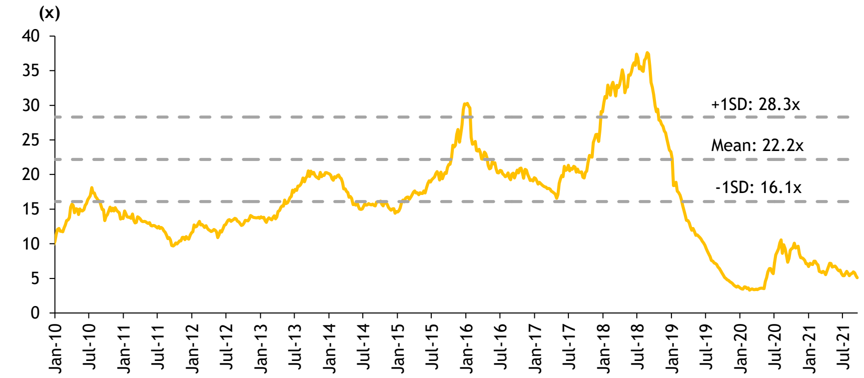
Source: Companies

Glove sector's 1-year forward PER



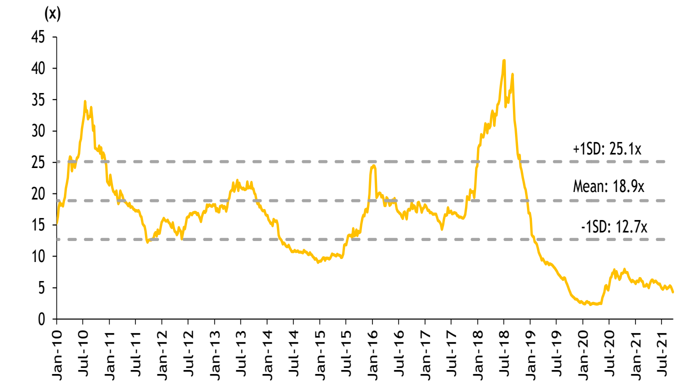
**Top Glove, Hartalega, Kossan and Supermax*
Source: Bloomberg, companies, Maybank Kim Eng (chart)

Glove sector's historical 1-year forward PER mean (pre-Covid: 2014-2018)*



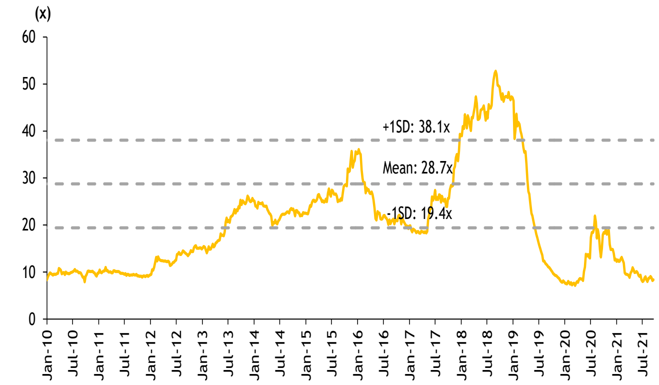
**Top Glove, Hartalega, Kossan and Supermax*
Source: Bloomberg, companies, *Maybank Kim Eng (chart)*

Top Glove: Historical 1-year forward PER mean (2014-2018; pre-Covid-19)



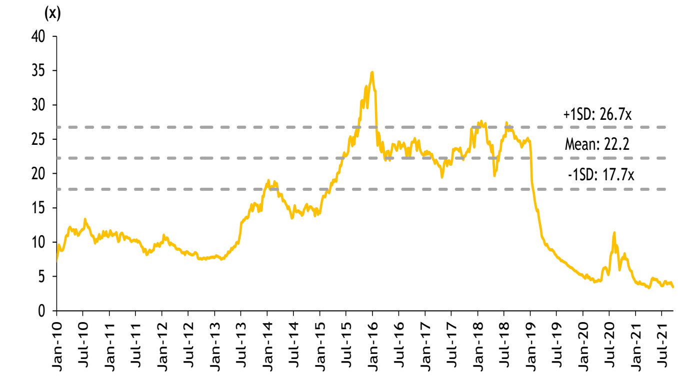
Source: Bloomberg, Company, Maybank Kim Eng (chart)

Harta: Historical 1-year forward PER mean (2014-2018; pre-Covid-19)



Source: Bloomberg, Company, Maybank Kim Eng (chart)

Kossan: Historical 1-year forward PER mean (2014-2018; pre-Covid-19)



Source: Bloomberg, Company, Maybank Kim Eng (chart)

Key upside risks to our call:

(i) USA reinstates the punitive import tariffs on China's exam and non-medical gloves, which may result in China losing competitive edges and market share in the US. Presently, the import tariff on China's runner examination gloves has reduced to zero (from 7.5% under the 'Phase 1' trade deal in Jan 2020 – the original import tariff was 15% in Sep 2019), (ii) Raw material prices to decline faster than ASP, (iii) Higher demand/consumption for gloves from non-healthcare industries post pandemic.

Shariah Compliant

Industrials

Malaysia

October 11, 2021

Maybank IB Research

Hartalega (HART MK)

Challenging ASP outlook

SELL [Prior:HOLD]

Share Price	MYR 5.89
12m Price Target	MYR 3.99 (-30%)
Previous Price Target	*MYR 6.74*

ASP downtrend to continue; D/G to SELL

We believe the strong 1QFY3/22 earnings performance will not be sustainable as ASP has been trending downward since May 21 on rising competition especially in the nitrile glove segment. We lower our FY22-24 earnings forecasts by -1% to -62% after lowering our utilisation rate and ASP assumptions. We downgrade Hartalega to SELL with a new TP of MYR3.99 (from MYR6.74) on an unchanged 19.4x CY23 PER (-1SD of historical mean).

ASP expected to only normalise in early 2022

Hartalega have been guiding for a weaker ASP outlook since 2Q21. ASP is expected to decline 30% between 1QFY22 and 2QFY22 and may only normalize in early 2022, returning to pre-COVID levels by mid-2022. Due to the stricter SOPs, it is currently operating at only 70% of its capacity, utilizing 60% of its workforce. Due to the unexpected 2-week shut down of operations in early July and stricter SOPs under the National Recovery Plan phase 1 that led to lower production, some of its buyers have shifted some of their orders to China in order to mitigate the supply risks, we understand.

China, a threat that cannot be ignored

Aggressive capacity expansion by the Chinese glove makers would likely lead to oversupply by 2023. To seize market share, the Chinese glove makers are pricing their gloves competitively in Europe. The Chinese glove makers are expected to contribute to 23% of the world's glove supply by 2022 (from 16% now) while Malaysia's market share is expected to shrink to 60% in 2022, from 67%.

Earnings adjustments

We lower our FY22/23/24 earnings forecasts by -1%/-60%/-33% to factor in: (i) lower utilisation rate of 70% (from 80%) for 4Q21, 80% (from 85%) for FY23 and 85% (from 93%) for FY24, and (ii) lower FY22/23/24 effective ASP assumptions of USD61.4/23.9/23.2 (from USD62.6/37.2/28.5) per k pcs. Post-earnings downgrade, our TP is lowered to MYR3.99 (from MYR6.74) on an unchanged 19.4x CY23 PER.

FYE Mar (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	2,924	6,696	7,683	3,911	4,442
EBITDA	724	4,065	4,755	1,032	1,124
Core net profit	435	2,975	3,485	666	716
Core FDEPS (sen)	12.9	86.6	101.5	19.4	20.8
Core FDEPS growth(%)	(5.5)	569.9	17.1	(80.9)	7.5
Net DPS (sen)	7.5	50.2	58.8	11.2	12.1
Core FD P/E (x)	53.2	10.3	5.8	30.4	28.3
P/BV (x)	9.1	6.1	3.1	3.0	2.9
Net dividend yield (%)	1.1	5.6	10.0	1.9	2.1
ROAE (%)	18.1	76.8	61.0	10.1	10.4
ROAA (%)	13.8	58.6	46.6	8.3	8.8
EV/EBITDA (x)	31.7	6.9	3.6	16.2	14.9
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	3,890	1,211	925
MKE vs. Consensus (%)	-	-	(10.4)	(45.0)	(22.6)

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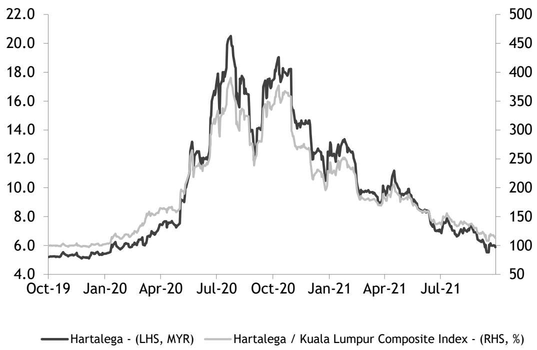
Company Description

Hartalega is the world's largest nitrile medical gloves producer.

Statistics

52w high/low (MYR)	19.04/5.53
3m avg turnover (USDm)	10.1
Free float (%)	34.3
Issued shares (m)	3,428
Market capitalisation	MYR20.2B
	USD4.8B
Major shareholders:	
Hartalega Industries Sdn. Bhd.	34.3%
Employees Provident Fund	8.6%
BNP Paribas Wealth Management	8.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(12)	(16)	(65)
Relative to index (%)	(10)	(19)	(66)

Source: FactSet

ESG@MKE
Tear Sheet Insert

ESG@MKE

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Risk Rating & Score[1]	17.6 (Low)
Score Momentum[2]	+0.0
Last Updated	21 July 2021
Controversy Score[3] (Updated: 30 Jul 2021)	3 - Human rights (employee incidents)

Business Model & Industry Issues

- Hartalega has continued to retain its SEDEX membership and remains a constituent of FTSE4Good Bursa Malaysia. Social compliance audits are regularly conducted by its internal team as well as external parties, based on the Business Social Compliance Initiative (BSCI) and SEDEX Members Ethical Trade Audits (SMETA).
- Similar to the other glove players, Hartalega relies on the migrant workers for the production of its gloves. Given the ever-changing regulations and standards on workers' welfare, the industry faces rising social compliance cost. However, as the entire industry faces the same challenges, we expect the glove-makers to pass on the higher compliance cost.
- ESG risk should fall on a yearly basis as it invests in automation to improve efficiency and reduce dependency on manual labour. Hartalega's vision is for humanless factories in the foreseeable future.

Material E issues

- To reduce the consumption of energy and water, Hartalega deploys a high level of automation at its plants and also taps into alternative energy sources (i.e. cogeneration and biomass power plants). In FY20, its natural gas, electricity and water consumption per unit of production were reduced by 15%, 24% and 2% respectively.
- It also put in place a waste reduction programme. In FY20, its scheduled and non-scheduled waste disposal per unit of production reduced by 26% and 12% respectively.
- Additionally, its state-of-the-art water treatment plants allow for 100% self-treated water. For effluent water discharge, Hartalega maintains its Standard A rating, which is the highest benchmark determined by the Department of Environment (DOE).
- Hartalega received ISO 14001:2015 certification in 2017.

Material S issues

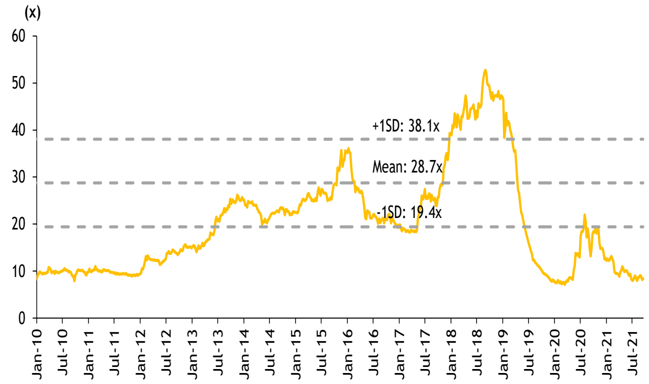
- Hartalega regularly carries out social compliance audits, which are in accordance with internationally recognised standards, including the SEDEX Member Ethical Trade Audit (SMETA) and Business Social Compliance Initiative (BSCI).
- Hartalega implemented Zero Recruitment Cost Policy since 2019, which ensures that its migrant workers are not required to pay recruitment fees to agencies/third parties during the recruitment process. For migrant workers that joined Hartalega prior to its Zero Recruitment Cost Policy, Hartalega will reimburse the recruitment fees paid by the migrant workers (totalling up to MYR40m) from 4Q20 (over a period of 24 months).
- Its migrant workers are paid no less than the minimum rates stipulated in Malaysian laws. The migrant workers are also eligible for cash bonuses of up to 3.5 months and annual increments of up to 7%.
- The overtime hours are paid at rates in accordance with the Malaysia Employment Act. Its workers typically perform 70 hours of overtime per month, which is below the limit of 104 hours allowed by Malaysia's labour laws.
- Its hostels also exceed the minimum standard enforced by Malaysia's Department of Labour.

Key G metrics and issues

- The current board consists of 8 members, out of which, 5 members (or 63% of board, minimum requirement is 50%) are Independent Non-Executive Directors (INEDs).
- Mr Kuan Kam Hon is the Executive Chairman of Hartalega and his total remuneration package for FY20 was MYR7.7m (or 1.8% of FY20 net profit).
- As at 22 Jun 2020, Mr Kuan Kam Hon's family (the largest substantial shareholder) holds 48.9% stake in Hartalega and has 3 board seats (or 38% of board representation).
- The service of Dato' Tan Guan Cheong (INED) will exceed 9 years in 2021 and the shareholders have approved his service at the recent AGM in Sep 2020.
- Hartalega has 3 female directors on the board, representing 38% of the board (minimum requirement is 30%).
- Its audit and remuneration committees are made up by the same 4 INEDs.
- Its risk management committee is made up of 4 INEDs and 1 Executive Director.
- Deloitte PLT has been Hartalega's external auditor since 2014.
- The Group has a Whistleblowing Policy in place, whereby the reports are lodged to an independent third-party outsourced service provider via email and/or website ("Hartalega Speak Up"), which are available in multiple languages (i.e. English, Bahasa Malaysia, Burmese, Bengali and Nepali).
- Hartalega has had no governance issues in the past. The only related party transactions were the dividend and interest income received from subsidiaries.
- The growth of the Group has been organic and hence, no business acquisitions.
  Its products have never been reprimanded by the authorities or its customers.

[1]***Risk Rating & Score*** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. [2]***Score Momentum*** - indicates changes to the company's score since the last update - a negative integer indicates a company's improving risk score; a positive integer indicates a deterioration. [3]***Controversy Score*** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Harta: Historical 1-year forward PER mean (2014-2018; pre-Covid-19)



Source: Bloomberg, Company, Maybank Kim Eng (chart)

Upside risks

(i) USA reinstates the punitive import tariffs on China's exam and non-medical gloves, which may result in China losing competitive edges and market share in the US. Presently, the import tariff on China's runner examination gloves has reduced to zero (from 7.5% under the 'Phase 1' trade deal in Jan 2020 – the original import tariff was 15% in Sep 2019), (ii) Raw material prices decline faster than ASP, (iii) Higher demand/consumption for gloves from non-healthcare industries post pandemic.

FYE 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics					
P/E (reported) (x)	41.4	15.7	5.8	30.2	28.1
Core P/E (x)	52.9	10.3	5.8	30.2	28.1
Core FD P/E (x)	53.2	10.3	5.8	30.4	28.3
P/BV (x)	9.1	6.1	3.1	3.0	2.9
P/NTA (x)	9.2	6.2	3.1	3.0	2.9
Net dividend yield (%)	1.1	5.6	10.0	1.9	2.1
FCF yield (%)	2.8	10.1	13.7	3.8	1.4
EV/EBITDA (x)	31.7	6.9	3.6	16.2	14.9
EV/EBIT (x)	38.4	7.2	3.7	19.9	18.6
INCOME STATEMENT (MYR m)					
Revenue	2,924.3	6,695.9	7,683.0	3,910.5	4,442.5
EBITDA	724.2	4,064.5	4,754.6	1,032.1	1,123.6
Depreciation	(125.1)	(137.4)	(164.9)	(192.4)	(219.9)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	599.1	3,927.1	4,589.6	839.7	903.7
Net interest income /(exp)	(7.6)	(0.9)	23.8	30.2	31.9
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	(90.0)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	556.3	3,813.4	4,613.4	869.9	935.6
Income tax	(120.4)	(909.8)	(1,107.2)	(200.1)	(215.2)
Minorities	(1.1)	(18.2)	(21.4)	(4.1)	(4.4)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	434.8	2,885.4	3,484.8	665.7	716.0
Core net profit	434.8	2,975.4	3,484.8	665.7	716.0
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	305.0	2,668.7	3,337.5	3,753.9	3,662.2
Accounts receivable	503.1	1,065.5	1,222.6	622.3	707.0
Inventory	276.1	646.7	742.1	377.7	429.1
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	2,002.1	2,156.4	2,541.5	2,899.0	3,229.1
Intangible assets	28.8	32.6	32.6	32.6	32.6
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	202.5	262.1	262.1	262.1	262.1
Total assets	**3,317.6**	**6,832.1**	**8,138.3**	**7,947.6**	**8,322.0**
ST interest bearing debt	85.4	105.0	105.0	105.0	105.0
Accounts payable	276.0	1,059.3	970.3	493.9	561.0
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	188.6	241.7	141.7	141.7	141.7
Other liabilities	223.0	427.0	427.0	427.0	427.0
Total Liabilities	**773.0**	**1,833.0**	**1,644.0**	**1,167.6**	**1,234.8**
Shareholders Equity	2,541.0	4,974.8	6,448.7	6,730.3	7,033.1
Minority Interest	3.6	24.2	45.6	49.7	54.1
Total shareholder equity	**2,544.6**	**4,999.0**	**6,494.3**	**6,780.0**	**7,087.2**
Total liabilities and equity	**3,317.6**	**6,832.1**	**8,138.3**	**7,947.6**	**8,322.0**
CASH FLOW (MYR m)					
Pretax profit	556.3	3,813.4	4,613.4	869.9	935.6
Depreciation & amortisation	125.1	137.4	164.9	192.4	219.9
Adj net interest (income)/exp	7.6	0.9	(23.8)	(30.2)	(31.9)
Change in working capital	(20.3)	(146.6)	(341.5)	488.3	(68.8)
Cash taxes paid	(72.7)	(730.8)	(1,107.2)	(200.1)	(215.2)
Other operating cash flow	59.7	13.3	0.0	0.0	0.0
Cash flow from operations	655.7	3,087.7	3,305.9	1,320.3	839.6
Capex	(3.1)	(2.2)	(550.0)	(550.0)	(550.0)
Free cash flow	652.6	3,085.5	2,755.9	770.3	289.6
Dividends paid	(249.0)	(604.2)	(2,010.9)	(384.2)	(413.2)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(78.1)	80.9	(100.0)	0.0	0.0
Other invest/financing cash flow	(170.9)	(204.6)	23.8	30.2	31.9
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	154.6	2,357.6	668.8	416.4	(91.7)

FYE 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	3.4	129.0	14.7	(49.1)	13.6
EBITDA growth	7.6	461.2	17.0	(78.3)	8.9
EBIT growth	5.2	555.5	16.9	(81.7)	7.6
Pretax growth	1.0	585.6	21.0	(81.1)	7.5
Reported net profit growth	(4.5)	563.6	20.8	(80.9)	7.5
Core net profit growth	(4.5)	584.3	17.1	(80.9)	7.5
Profitability ratios (%)					
EBITDA margin	24.8	60.7	61.9	26.4	25.3
EBIT margin	20.5	58.6	59.7	21.5	20.3
Pretax profit margin	19.0	57.0	60.0	22.2	21.1
Payout ratio	57.7	59.5	57.7	57.7	57.7
DuPont analysis					
Net profit margin (%)	14.9	43.1	45.4	17.0	16.1
Revenue/Assets (x)	0.9	1.0	0.9	0.5	0.5
Assets/Equity (x)	1.3	1.4	1.3	1.2	1.2
ROAE (%)	18.1	76.8	61.0	10.1	10.4
ROAA (%)	13.8	58.6	46.6	8.3	8.8
Liquidity & Efficiency					
Cash conversion cycle	60.6	15.3	12.6	62.9	39.9
Days receivable outstanding	59.2	42.2	53.6	84.9	53.9
Days inventory outstanding	45.5	60.2	88.9	71.5	45.3
Days payables outstanding	44.1	87.1	129.9	93.5	59.3
Dividend cover (x)	1.7	1.7	1.7	1.7	1.7
Current ratio (x)	2.7	3.1	4.1	5.7	5.4
Leverage & Expense Analysis					
Asset/Liability (x)	4.3	3.7	5.0	6.8	6.7
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	78.6	nm	na	na	na
Debt/EBITDA (x)	0.4	0.1	0.1	0.2	0.2
Capex/revenue (%)	0.1	0.0	7.2	14.1	12.4
Net debt/ (net cash)	(31.0)	(2,322.0)	(3,090.8)	(3,507.2)	(3,415.5)

Source: Company; Maybank

Maybank IB Research

Shariah Compliant

Industrials

Malaysia

Kossan Rubber Industries (KRI MK)

ASP downtrend to continue

SELL [Prior:HOLD]

Share Price	MYR 2.34
12m Price Target	MYR 1.86 (-19%)
Previous Price Target	*MYR 3.16*

Challenging ASP outlook; D/G to SELL

We believe Kossan's strong 1H21 earnings performance will not be sustainable as ASP has been trending down since May 2021 on rising competition, especially in the nitrile glove segment. We lower our FY21-23 earnings forecasts by -1% to -76% on lower utilisation rates and ASP assumptions. We downgrade Kossan to SELL with a new TP of MYR1.86 (from MYR3.16) on a lower 17.7x CY23 PER or -1SD of historical mean (from -0.5SD of mean), in line with our valuation basis for Top Glove and Hartalega.

ASP expected to return to pre-Covid level in 2022

Industry players have been guiding for a weaker ASP outlook since 2Q21. ASP is expected to decline -8% to -10% MoM (peak: USD130-140/k pcs in early 2021 vs. c.USD40/k pcs in Sep 21) and could return to pre-Covid levels of USD23-24/k pcs by mid-2022, representing a 42% decline from the current level, in our view. Elsewhere, the sector is also facing other challenges such as lower utilization rates and additional operating costs on stricter SOPs as well as the labour shortage.

Strong competition from the Chinese glove makers

Aggressive capacity expansion by the Chinese glove makers would likely lead to oversupply by 2023. To seize market share, the Chinese glove makers are pricing their gloves competitively in Europe. According to industry players, the Chinese glove makers are expected to contribute to 23% of the world's glove supply by 2022 (from 16% now) while Malaysia's market share is expected to shrink to 60% in 2022, from 67%.

Earnings adjustments

We lower our FY22/23/24 earnings forecasts by -1.3%/-75.8%/-33.4% to factor in: (i) lower utilisation rate of 70% (from 80%) for 4Q21, 80% for FY22 and FY23 (from 85% and 93%, respectively) and (ii) lower FY22/23 blended ASP assumptions to USD26.4/22.7 (from USD47.8/28.7) per k pcs. Post-earnings downgrade, our TP is lowered to MYR1.86 (from MYR3.16) on a lower 17.7x CY23 PER (-1SD to historical mean).

FYE Dec (MYR m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	2,217	3,654	7,224	3,602	3,457
EBITDA	383	1,510	3,790	632	506
Core net profit	225	1,036	2,783	374	269
Core EPS (sen)	8.8	40.5	108.8	14.6	10.5
Core EPS growth (%)	12.5	361.3	168.5	(86.6)	(28.1)
Net DPS (sen)	3.0	14.0	37.6	5.1	3.6
Core P/E (x)	23.7	11.1	2.2	16.0	22.3
P/BV (x)	3.7	4.8	1.4	1.3	1.3
Net dividend yield (%)	1.4	3.1	16.1	2.2	1.6
ROAE (%)	16.4	57.0	84.4	8.6	5.9
ROAA (%)	10.0	35.0	59.9	6.7	4.9
EV/EBITDA (x)	15.0	7.3	1.2	6.2	7.5
Net gearing (%) (incl perps)	27.7	net cash	net cash	net cash	net cash
Consensus net profit	-	-	3,107	942	524
MKE vs. Consensus (%)	-	-	(10.4)	(60.3)	(48.7)

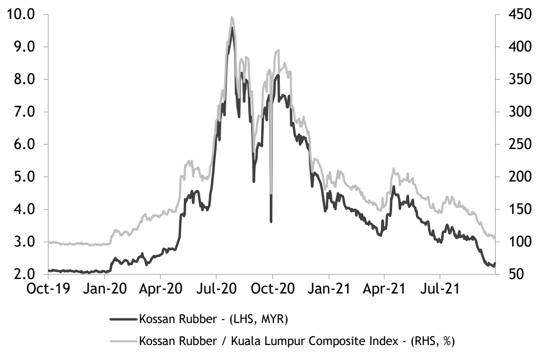
Company Description

Kossan is among the world's biggest glove producers with production highly concentrated in the nitrile segment.

Statistics

52w high/low (MYR)	8.13/2.24
3m avg turnover (USDm)	4.3
Free float (%)	42.7
Issued shares (m)	2,558
Market capitalisation	MYR6.0B
	USD1.4B
Major shareholders:	
Kossan Holdings Malaysia Sdn. Bhd.	47.0%
Employees Provident Fund	8.6%
Public Mutual Bhd.	3.0%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(21)	(23)	(35)
Relative to index (%)	(20)	(26)	(37)

Source: FactSet

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Risk Rating & Score[1]	20.0 (Medium)
Score Momentum[2]	N/A
Last Updated	11 Aug 2021
Controversy Score[3] (Updated: 20 July 2021)	3 – Human rights (employee incidents)

Business Model & Industry Issues

- Similar to the other glove players, Kossan relies on the migrant workers for the production of its gloves. Given the ever-changing regulations and standards on workers' welfare, the industry faces rising social compliance cost.
- Backed by its strong balance sheet and technological know-how, we think Kossan would be able to raise its automation and efficiency across its entire operation. This would result in higher productivity, lower headcount and better cost competitiveness (vs. the smaller peers).
- Kossan frequently attends to social audits by its customers and maintains its Supplier (B) membership in SEDEX. However, improved disclosures on its environmental impacts and targets would be well-received. Additionally, a more diversified board composition (i.e. more Independent Non-Executive Directors and female representation) would increase its corporate governance quality.

Material E issues

- Applies an Environmental Management System Framework across all its plants to ensure standardised and systematic workflows. Out of its total 23 plants, 2 of its TRP plants are ISO 14001:2015 certified (internationally recognised standards for environmental responsibilities).
- Effluent discharge - Complies with local regulations and maintains Standard B rating.
- Natural gas – Undertake various energy-saving measures such as optimal manufacturing line operations and temperature, heat recovery and recycling, heat loss reduction and heat conservation.
- Solar energy – In Dec 19, installed solar panels at its Plant 19, which could generate 315.58kWh per million gloves. Moving forward, more solar panels will be installed.

Material S issues

- Labour practices – Kossan hires c.4,000 migrant workers. The migrant workers hold their own passports, have unrestricted freedom of movement during working or non-working hours and are free to resign at any time without any penalty.
- Minimum wage – Complies with the local statutory monthly minimum wage.
- Overtime – Workers are not allowed to work more than 104 hours a month, as stipulated by the local regulation.
- Zero-Cost Recruitment Policy – Since May 19, all recruitment fees and associated costs (i.e. passports, documentation, approvals, medical check-ups, travelling) are fully-borne by Kossan. For workers that have already paid recruitment fees prior to May 19, Kossan has set aside a total sum of MYR50m as remediation fees and has started reimbursing the workers since Nov 20 (to be paid over 18 months).
- Dormitories – Complies with Malaysia's regulation (Act 446), which stipulates minimum space of 46 sq. ft. per worker and is also higher than the International Labour Organisation's (ILO) standard of 36 sq. ft. per worker.
- Covid-19 screening of workers – To undertake sampling testing every 2 weeks to ensure fast containment.

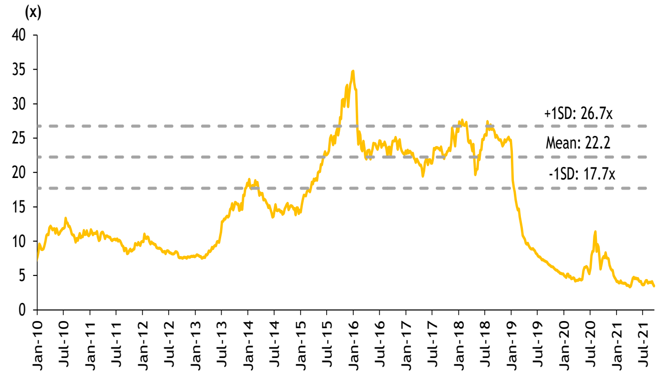
Key G metrics and issues

- Out of the total 9 members on the board, only 3 members are Independent Non-Executive Directors (INEDs). This represents 33% of the board and is below the minimum requirement of 50%. Kossan will review the composition of the board annually with a view to achieving compliance.
- None of the INEDs have served more than 9 years on the board.
- There is only 1 female member on the board, representing 11% of the board and below the minimum requirement of 30%. Going forward, Kossan will place gender diversity as one of the considerations for new appointments to the board.
- Its Audit, Risk Management, and Nomination Committees are chaired by INEDs.
- The Chairman, Mohamed Shafeii Bin Abdul Gaffoor, is an INED.
- The MD/CEO is Tan Sri Dato' Lim Kuang Sia and his total remuneration was MYR6m in FY19 (or 3% of FY19 net profit). Together with his family, the Lim family holds a 47% stake in Kossan.
- In FY19, the remuneration package for the board was MYR13m (or 6% of FY19 net profit).
- KPMG has been Kossan's external auditor for more than 10 years.
- Related party transactions (RPTs) have been insignificant to the group. In FY19, Kossan paid a total of MYR8m (<1% of total costs) to related parties, mainly for the lease and purchases of consumables. It also received MYR18m (<1% of total revenue) from related parties, mainly for the management fee and rental income.

  Kossan also has Whistle-Blowing Policy in place.

[1] ***Risk Rating & Score*** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. [2] ***Score Momentum*** - indicates changes to the company's score since the last update - a negative integer indicates a company's improving risk score; a positive integer indicates a deterioration. [3] ***Controversy Score*** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Kossan: Historical 1-year forward PER mean (2014-2018; pre-Covid-19)



Source: Bloomberg, Company, Maybank Kim Eng (chart)

Upside risks

(i) USA reinstates the punitive import tariffs on China's exam and non-medical gloves, which may result in China losing competitive edges and market share in the US. Presently, the import tariff on China's runner examination gloves has reduced to zero (from 7.5% under the 'Phase 1' trade deal in Jan 2020 – the original import tariff was 15% in Sep 2019), (ii) Raw material prices to decline faster than ASP, (iii) Higher demand/consumption for gloves from non-healthcare industries post pandemic.

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	22.6	11.4	2.2	16.0	22.3
Core P/E (x)	23.7	11.1	2.2	16.0	22.3
P/BV (x)	3.7	4.8	1.4	1.3	1.3
P/NTA (x)	3.7	4.8	1.4	1.3	1.3
Net dividend yield (%)	1.4	3.1	16.1	2.2	1.6
FCF yield (%)	1.6	8.1	29.7	15.0	2.5
EV/EBITDA (x)	15.0	7.3	1.2	6.2	7.5
EV/EBIT (x)	20.0	7.9	1.3	8.1	11.3
INCOME STATEMENT (MYR m)					
Revenue	2,217.2	3,653.5	7,224.2	3,601.5	3,457.0
EBITDA	383.4	1,510.5	3,789.5	631.5	505.9
Depreciation	(95.7)	(110.1)	(126.8)	(150.1)	(170.1)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	287.7	1,400.3	3,662.8	481.4	335.8
Net interest income /(exp)	(11.3)	(6.5)	6.1	18.2	25.4
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	50.7	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	276.4	1,444.6	3,668.9	499.7	361.2
Income tax	(48.5)	(352.0)	(880.5)	(119.9)	(86.7)
Minorities	(3.2)	(5.5)	(5.5)	(5.5)	(5.5)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	224.7	1,087.1	2,782.8	374.2	269.0
Core net profit	224.7	1,036.3	2,782.8	374.2	269.0
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	162.9	1,089.2	1,810.5	2,495.7	2,479.0
Accounts receivable	432.9	629.6	1,385.5	690.7	663.0
Inventory	324.5	444.0	989.6	493.4	473.6
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1,398.0	1,268.3	1,391.5	1,591.4	1,721.3
Intangible assets	4.9	4.9	4.9	4.9	4.9
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	22.1	138.5	138.5	138.5	138.5
Total assets	**2,345.4**	**3,574.6**	**5,720.6**	**5,414.6**	**5,480.3**
ST interest bearing debt	392.9	447.8	347.8	247.8	147.8
Accounts payable	249.1	431.8	851.1	394.7	378.8
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	172.3	107.0	107.0	107.0	107.0
Other liabilities	77.0	174.0	174.0	174.0	174.0
Total Liabilities	**891.3**	**1,160.2**	**1,479.4**	**923.0**	**807.2**
Shareholders Equity	1,427.1	2,385.6	4,206.9	4,451.8	4,627.8
Minority Interest	27.0	28.7	34.3	39.8	45.3
Total shareholder equity	**1,454.1**	**2,414.4**	**4,241.1**	**4,491.6**	**4,673.1**
Total liabilities and equity	**2,345.4**	**3,574.6**	**5,720.6**	**5,414.6**	**5,480.3**
CASH FLOW (MYR m)					
Pretax profit	276.4	1,444.6	3,668.9	499.7	361.2
Depreciation & amortisation	95.7	110.1	126.8	150.1	170.1
Adj net interest (income)/exp	11.3	6.5	(6.1)	(18.2)	(25.4)
Change in working capital	(13.1)	(140.7)	(882.2)	734.6	31.7
Cash taxes paid	(62.5)	(352.0)	(880.5)	(119.9)	(86.7)
Other operating cash flow	3.3	32.2	0.0	0.0	0.0
Cash flow from operations	311.1	1,100.7	2,026.8	1,246.3	450.9
Capex	(224.8)	(171.5)	(250.0)	(350.0)	(300.0)
Free cash flow	86.3	929.1	1,776.8	896.3	150.9
Dividends paid	(115.2)	(115.4)	(961.6)	(129.3)	(92.9)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	58.4	(10.5)	(100.0)	(100.0)	(100.0)
Other invest/financing cash flow	(12.9)	137.5	6.1	18.2	25.4
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	16.6	926.9	721.3	685.2	(16.7)

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	3.6	64.8	97.7	(50.1)	(4.0)
EBITDA growth	12.4	293.9	150.9	(83.3)	(19.9)
EBIT growth	8.8	386.8	161.6	(86.9)	(30.3)
Pretax growth	10.9	422.7	154.0	(86.4)	(27.7)
Reported net profit growth	12.5	383.9	156.0	(86.6)	(28.1)
Core net profit growth	12.5	361.3	168.5	(86.6)	(28.1)
Profitability ratios (%)					
EBITDA margin	17.3	41.3	52.5	17.5	14.6
EBIT margin	13.0	38.3	50.7	13.4	9.7
Pretax profit margin	12.5	39.5	50.8	13.9	10.4
Payout ratio	34.2	32.9	34.6	34.6	34.6
DuPont analysis					
Net profit margin (%)	10.1	29.8	38.5	10.4	7.8
Revenue/Assets (x)	0.9	1.0	1.3	0.7	0.6
Assets/Equity (x)	1.6	1.5	1.4	1.2	1.2
ROAE (%)	16.4	57.0	84.4	8.6	5.9
ROAA (%)	10.0	35.0	59.9	6.7	4.9
Liquidity & Efficiency					
Cash conversion cycle	82.6	59.3	58.4	118.7	82.7
Days receivable outstanding	70.6	52.3	50.2	103.8	70.5
Days inventory outstanding	58.4	60.6	78.1	93.6	60.9
Days payables outstanding	46.4	53.7	69.9	78.6	48.7
Dividend cover (x)	2.9	3.0	2.9	2.9	2.9
Current ratio (x)	1.5	2.4	3.4	5.4	6.4
Leverage & Expense Analysis					
Asset/Liability (x)	2.6	3.1	3.9	5.9	6.8
Net gearing (%) (incl perps)	27.7	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	27.7	net cash	net cash	net cash	net cash
Net interest cover (x)	25.4	nm	na	na	na
Debt/EBITDA (x)	1.5	0.4	0.1	0.6	0.5
Capex/revenue (%)	10.1	4.7	3.5	9.7	8.7
Net debt/ (net cash)	402.3	(534.4)	(1,355.7)	(2,140.9)	(2,224.3)

Source: Company; Maybank

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