Maybank Investment Bank

Industrials

Malaysia

Malaysia Gloves Sector

NEGATIVE *[Unchanged]*

Enduring (painful) structural change

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Demand-supply will take time to rebalance

As ASP/ earnings outlook remains challenging, the glove makers have postponed/put their capacity expansion plans on hold. Demand-supply disequilibrium will take time to rebalance and price war is inevitable. Strong balance sheet is paramount to ride out the storm. We lower our earnings forecasts by -16% to -42% after assuming lower utilization rate of 70% (from 75-80%) and cut out TPs after we roll over our base year for valuation. Maintain NEGATIVE. We are SELLers of TOPG, HARTA and KRI.

Recent results point to further weakness

Despite pickup in orders (on resumption of restocking activities) and stabilising ASP (due to rising raw material prices), margin contraction is to continue as glove makers are unable to fully pass-on the higher costs to customers due to stiff competition. As the cost-plus model that was widely used pre-Covid may no longer be relevant in the current over-supplied market, we are expecting contraction in margin post-Covid. In view of the tough operating environment, both the local (TOPG and HARTA) and Chinese (Intco Medical Technology; 300677 CH; Not rated) glove makers have decided to put their capacity expansions on hold.

Oversupply situation is unlikely to be solved so soon

As most of the glove makers (excluding new players) have accumulated large war chests during the upcycle in 2020-2021 and are in defensive mode, industry consolidation (that should lead to lower supply) is unlikely to happen in a significant way in the short-term, we think. Losses are likely if the price war is seen to be escalating, we believe. We understand that current ASP is around USD22-24/k pcs (vs. Chinese makers of below USD20/k pcs).

Maintain NEGATIVE

We believe strong balance sheets and cost efficiency are important factors that will allow glove makers to weather through the downturn and provide some financial cushion for price war. TOPG, HARTA and KRI have accumulated sizeable amounts of cash during the peak cycle and are now in net cash positions (TOPG: MYR0.07/sh net cash, 0.12x total cash/market capitalization ratio, HARTA: MYR0.62/sh/0.25x, KRI: MYR0.57/sh/0.5x). We cut our earnings forecasts for TOPG, KRI and HARTA by -16% to -42% after assuming lower utilization rate of 70% (from 75%). We D/G KRI to SELL (from HOLD) while maintaining SELLs on TOPG and HARTA after we roll over our base year for valuation.

Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x) 22E	P/E (x) 23E	P/B (x) 22E	P/B (x) 23E	Div yld (%) 22E	Div yld (%) 23E
Hartalega	HART MK	2,131	Sell	2.74	2.48	(7)	5.1	20.9	3.2	1.8	11.7	2.9
Top Glove	TOPG MK	1,881	Sell	1.01	0.65	(34)	27.0	19.5	1.1	1.1	1.9	2.6
Kossan Rubber	KRI MK	755	Sell	1.30	1.10	(14)	12.4	17.2	0.8	0.8	2.8	2.0

 PP16832/01/2013 (031128)

Negative structural change is real

Recent quarterly results of glove makers confirm our belief that the sector is undergoing a negative structural change with the involvement of the Chinese glove makers. Despite pickup in orders (on resumption of restocking activities) and stabilising ASP (due to rising raw material prices), margin contraction is to continue as glove makers are unable to fully pass-on the higher production costs (raw materials, manpower and electricity) to customers due to stiff competition. As a result, both TOPG and HARTA have guided that the upcoming quarterly results would likely be weaker QoQ.

There is high chance that the cost-plus model that was widely used pre-Covid may no longer be relevant amid stiff competition, in our view. Losses are likely if the price war is seen to be escalating, we believe. We understand that current ASP is around USD22-24/k pcs (versus Chinese makers of below USD20/k pcs).

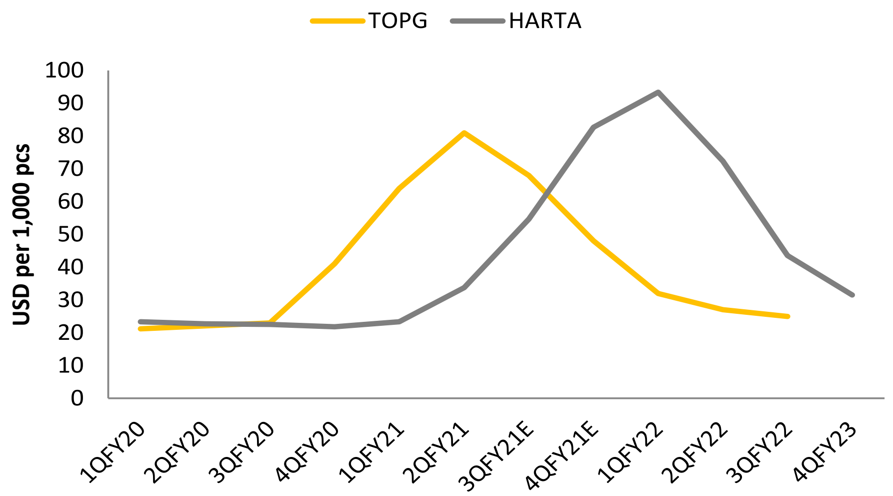
Glove makers (under our coverage)' latest quarterly results

Company	FYE	Quarterly results	Results below/in line/above expectation	Net cash (MYRm)	Net cash (MYR/sh)	Total cash (MYRm)	Market capitalisation (MYRm)	Total cash/market cap ratio (x)
Top Glove*	Aug	3QFY22	Below	562.9	**0.07**	1,003.7	8,289.1	**0.12**
Hartalega	Mar	4QFY22	Above	2,139.4	**0.62**	2,378.1	9,391.0	**0.25**
Kossan	Dec	1QFY22	Above	1,467.7	**0.57**	1,676.0	3,325.0	**0.50**

** excluding perpetual sukuk of MYR1.2b as at May 2022*

Source: Companies

ASP (USD/1,000 pcs) continued to spiral lower



Source: Companies, Maybank IBG Research (Chart)

Unlikely to repeat the glory days

Lately, interest in glove stocks have been boosted by the rising cases of Monkeypox in Europe, which has case fatality ratio of 3-6%. Nevertheless, we are of the view that the Monkeypox outbreak is unlikely to stir demand (and ASP) for gloves significantly given the availability of vaccine, better tracking and close monitoring by most countries and more importantly, ample supply of gloves (Malaysian glove makers' average utilization rate is around 50-70%). Also, with the experiences accumulated over the last two years, we believe supply can be ramped up within a short period. As such, the recent run-up glove stock prices is unlikely to sustain, we believe.

Earnings adjustments

In view of the oversupply situation, we lower our utilization rate assumption to 70%, from 75-80% previously while keeping our ASP assumption of USD23/k pcs (similar to pre-pandemic level) for 2023/2024 for now. Consequently, we lower our FY23/FY24/25 earnings forecasts for HARTA by -16%/-33%/-36%, KRI's FY23/FY24 earnings estimates by -28%/-42% and TOPG's earnings FY23/24 earnings estimates by -27%/-31%. As we roll over our base year for valuations, our TPs have been lowered to MYR2.48 (on an unchanged 19.4x CY24 PER) for HARTA (from MYR3.14), MYR1.10 (on an unchanged 17.7x CY24 PER) for KRI (from MYR1.85) and MYR0.65 (on an unchanged 12.7x CY24 PER) for TOPG (from MYR0.91).

Gloves: Change in TPs after the earnings downgrade. We have also rolled over our base year for valuation

	% Change in earnings forecasts		Change in TP (MYR/sh)				Stock rating	
Company	**FY23**	**FY24**	**Old**	**Valuation basis (CY23 PER)**	**New**	**Valuation basis (CY24 PER)**	**Old**	**New**
Top Glove	-27	-31	0.91	12.7	**0.65**	12.7	SELL	**SELL**
Hartalega	-16.0	-33	3.14	19.4	**2.48**	19.4	SELL	**SELL**
Kossan	-28	-42	1.85	17.7	**1.10**	17.7	HOLD	**SELL**

Source: Companies

Valuation and recommendation

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. We believe strong balance sheets and cost efficiency are important factors that will allow glove makers to weather through the downturn and provide some financial cushion for price war. TOPG, HARTA and KRI have accumulated sizeable amounts of cash during the peak cycle and are now in net cash positions (TOPG: MYR0.07/sh net cash, 0.12x total cash/market capitalization ratio, HARTA: MYR0.62/sh/0.25x, KRI: MYR0.57/sh/0.5x)

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 a very short period, we understand that these new entrants paid premium pricing for their plants, installation works, machineries, raw materials and even staff; hence, high operating costs, making them less competitive in price. From our channel checks, we understand that some of the new players have halted their production due to low ASP and are looking to exit the industry, while others have started cutting staff. Established glove makers such as HARTA and TOPG do not discount the possibility of buying/acquiring existing factories. HARTA has even set up a team to explore M&A opportunities, we were told.

Shariah Compliant

Industrials

Malaysia

July 3, 2022

Maybank Investment Bank

Kossan Rubber Industries (KRI MK)

ASP outlook remains challenging

SELL [Prior:HOLD]

Share Price	MYR 1.30
12m Price Target	MYR 1.10 (-14%)
Previous Price Target	*MYR 1.85*

ASP downturn yet to find bottom

As ASP/earnings outlook remains challenging, KRI may slow down its capacity expansion plans according to market condition. Demand-supply disequilibrium will take time to rebalance and price war appears inevitable. Fortunately, KRI has a strong balance sheet (MYR0.57/sh net cash; 0.5x total cash/market cap ratio) to ride out the storm. We lower our FY23/24 earnings forecasts by -28% to -42% and TP to MYR1.10 (on an unchanged 17.7x CY24 PER, -1SD vs. historical mean [pre-Covid]) after rolling over our base year for valuation. D/G to SELL.

May not be able to fully pass on higher costs

Recent results of major glove makers underlined the challenges faced by the Malaysian glove makers. Despite pickup in orders and stabilising ASP (due to rising raw material prices), margin contraction is to continue as glove makers have been unable to fully pass-on the higher production costs (raw materials, manpower and electricity) to customers due to stiff competition. As a result, we expect KRI's upcoming 2QFY22 results (Apr-June 22) which will be released on 26 July to be weaker QoQ on higher operating costs.

Strong balance sheet provides cushion for price war

As at Mar 22, KRI's net cash stood at MYR1.5b (57 sen/sh) while total cash of MYR1.7b accounted for 50% of its market capitalization of MYR3.3b. We believe the strong balance sheet will allow KRI to weather through the downturn and provide some financial cushion to the price war and self-fund its capacity expansions for the next few years. KRI intends to raise its capacity to 38.5b pcs in 2023 (2022: 33.5b pcs).

Earnings adjustments

Given the oversupply situation, we lower our utilization rate assumption to 70% (from 75% previously) while keeping our ASP assumption of USD23/k pcs (similar to pre-pandemic level) for 2023/2024 for now. Consequently, we lower our FY23/FY24 earnings forecasts for KRI by -28%/-42%. As we roll over our base year for valuations, our new TP for KRI is MYR1.10 (from MYR1.85) on an unchanged 17.7x CY24 PER (-1SD vs. historical mean [pre-Covid]).

FYE Dec (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	3,638	6,657	3,118	2,979	3,167
EBITDA	1,510	3,924	460	375	348
Core net profit	1,036	2,904	269	193	159
Core EPS (sen)	40.5	113.5	10.5	7.5	6.2
Core EPS growth (%)	361.1	180.3	(90.7)	(28.3)	(17.4)
Net DPS (sen)	14.0	48.0	3.7	2.6	2.2
Core P/E (x)	11.1	1.7	12.4	17.2	20.9
P/BV (x)	4.8	1.2	0.8	0.8	0.7
Net dividend yield (%)	3.1	25.0	2.8	2.0	1.7
ROAE (%)	57.0	88.9	6.5	4.5	3.6
ROAA (%)	34.7	66.9	5.3	3.7	2.9
EV/EBITDA (x)	7.3	0.7	1.3	1.5	1.6
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	301	327	369
MKE vs. Consensus (%)	-	-	(10.6)	(41.0)	(56.8)

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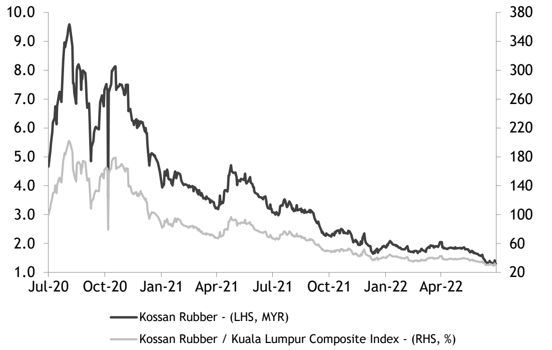
Company Description

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

Statistics

52w high/low (MYR)	3.53/1.27
3m avg turnover (USDm)	1.7
Free float (%)	44.2
Issued shares (m)	2,558
Market capitalisation	MYR3.3B
	USD755M
Major shareholders:	
Kossan Holdings Malaysia Sdn. Bhd.	47.9%
Employees Provident Fund	6.1%
Public Mutual Bhd.	3.0%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(21)	(37)	(59)
Relative to index (%)	(16)	(30)	(57)

Source: FactSet

ESG@MAYBANK IBG
Tear Sheet Insert

PP16832/01/2013 (031128)

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Risk Rating & Score[1]	19.6 (Low)
Score Momentum[2]	N/A
Last Updated	27 May 2022
Controversy Score[3] (Updated: 20 Jul 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.
- KRI employs a 3R strategy to Reduce, Reuse and Recycle to manage the impacts of pollutants that come from its manufacturing activities. These include the review of chemical types and optimising processes and usage quantities, reusing of containers and the recycling of used lubricant oil.
- Effluent processing and discharge is constantly monitored and managed to ensure the discharge quality is maintained at Standard B, in compliance with local environmental regulations.
- Other initiatives include optimising plant processes to reduce consumption volume and reusing of tank water in the manufacturing line. In 2021, KRI recorded a water consumption of 7,627,788 m3 at while usage of recycled water amounting to 9% of total water consumption.

Material S issues

- KRI's recruitment policies for migrant workers are guided by its Employee Pays (Zero-Cost) Policy. KRI will ensure its recruitment practices protect workers from debt bondage prohibit coercion into employment and allow freedom of movement. Workers found to have paid recruitment fees would be remediated immediately. KRI announced its Remediation Program in Oct 20 and completed remediation payments in June 21 at a total cost of MYR54m.
- In FY21, KRI stepped up its grievance mechanism for its migrant workers by transitioning from an in-house grievance channel to a helpline managed by an independent third-party service provider with the relevant professional and language capabilities. The channel is called *Suara Kami*.
- Overtime – Workers are not allowed to work more than 104 hours a month, as stipulated by the local regulation while a minimum of 1 rest day per week is compulsory.
- 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.
- 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.

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%.
- 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, KRI will place gender diversity as one of the considerations for new appointments to the board.
- Its Audit, Risk Management, remuneration and Nominating Committees are chaired by INEDs.
- The Chairman, Mohamed Shafeii Bin Abdul Gaffoor, is an INED.
- In FY21, the remuneration package for the board was MYR23.6m (or 0.8% of FY21 net profit).
- KPMG has been KRI's external auditor for more than 10 years.
- Related party transactions (RPTs), which mainly for the lease and purchases of consumables have been insignificant to the group. It also received from related parties, mainly for the management fee and rental income.
- KRI 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).

Upside risks

i) Raw material prices to decline faster than ASP, (ii) Demand-supply disequilibrium take shorter time to rebalance, (iii) Higher demand/consumption for gloves from non-healthcare industries post pandemic, (iv)industry consolidation that reduce oversupply risk and (v) higher-than-expected ASP.

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics					
P/E (reported) (x)	11.4	2.9	12.4	17.2	20.9
Core P/E (x)	11.1	1.7	12.4	17.2	20.9
P/BV (x)	4.8	1.2	0.8	0.8	0.7
P/NTA (x)	4.8	1.2	0.8	0.8	0.8
Net dividend yield (%)	3.1	25.0	2.8	2.0	1.7
FCF yield (%)	8.3	61.0	14.9	2.3	0.8
EV/EBITDA (x)	7.3	0.7	1.3	1.5	1.6
EV/EBIT (x)	7.9	0.7	1.8	2.5	3.1
INCOME STATEMENT (MYR m)					
Revenue	3,638.5	6,657.5	3,118.0	2,979.4	3,166.9
EBITDA	1,509.6	3,923.6	460.0	374.7	348.3
Depreciation	(113.6)	(115.4)	(132.1)	(148.8)	(165.4)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	1,396.0	3,808.2	327.9	225.9	182.9
Net interest income /(exp)	(5.3)	20.5	30.3	32.2	31.2
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	50.7	(50.0)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	1,441.4	3,747.8	358.3	258.1	214.1
Income tax	(349.3)	(890.9)	(86.0)	(62.0)	(51.4)
Minorities	(5.4)	(3.3)	(3.3)	(3.3)	(3.3)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	1,086.7	2,853.5	269.0	192.9	159.4
Core net profit	1,035.9	2,903.5	269.0	192.9	159.4
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	1,089.5	2,557.5	3,089.8	3,231.8	3,334.4
Accounts receivable	677.3	573.8	268.7	256.8	272.9
Inventory	440.1	424.0	198.6	189.8	201.7
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1,273.7	1,373.3	1,491.2	1,592.4	1,677.0
Intangible assets	6.1	6.1	6.1	6.1	6.1
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	147.4	115.0	115.0	115.0	115.0
Total assets	**3,634.0**	**5,049.6**	**5,169.4**	**5,391.9**	**5,607.2**
ST interest bearing debt	447.9	193.9	296.6	396.6	496.6
Accounts payable	486.4	297.9	139.5	133.3	141.7
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	107.2	43.5	43.5	43.5	43.5
Other liabilities	179.0	455.0	452.0	452.0	452.0
Total Liabilities	**1,220.7**	**990.4**	**932.0**	**1,025.8**	**1,134.2**
Shareholders Equity	2,384.8	4,031.5	4,206.4	4,331.8	4,435.4
Minority Interest	28.4	27.7	31.0	34.3	37.6
Total shareholder equity	**2,413.2**	**4,059.3**	**4,237.4**	**4,366.1**	**4,473.0**
Total liabilities and equity	**3,634.0**	**5,049.6**	**5,169.4**	**5,391.9**	**5,607.2**
CASH FLOW (MYR m)					
Pretax profit	1,441.4	3,747.8	358.3	258.1	214.1
Depreciation & amortisation	113.6	115.4	132.1	148.8	165.4
Adj net interest (income)/exp	5.3	(20.5)	(30.3)	(32.2)	(31.2)
Change in working capital	(95.3)	(50.0)	372.1	14.6	(19.7)
Cash taxes paid	(258.8)	(601.4)	(86.0)	(62.0)	(51.4)
Other operating cash flow	83.7	1,221.9	0.0	0.0	0.0
Cash flow from operations	1,136.1	3,213.4	746.1	327.3	277.2
Capex	(179.3)	(217.7)	(250.0)	(250.0)	(250.0)
Free cash flow	956.8	2,995.7	496.1	77.3	27.2
Dividends paid	(153.8)	(1,199.9)	(94.1)	(67.5)	(55.8)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(14.0)	(314.9)	100.0	100.0	100.0
Other invest/financing cash flow	142.4	0.0	30.3	32.2	31.2
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	924.1	1,468.0	532.3	142.0	102.6

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	64.1	83.0	(53.2)	(4.4)	6.3
EBITDA growth	293.7	159.9	(88.3)	(18.5)	(7.0)
EBIT growth	385.2	172.8	(91.4)	(31.1)	(19.1)
Pretax growth	421.5	160.0	(90.4)	(27.9)	(17.1)
Reported net profit growth	383.7	162.6	(90.6)	(28.3)	(17.4)
Core net profit growth	361.1	180.3	(90.7)	(28.3)	(17.4)
Profitability ratios (%)					
EBITDA margin	41.5	58.9	14.8	12.6	11.0
EBIT margin	38.4	57.2	10.5	7.6	5.8
Pretax profit margin	39.6	56.3	11.5	8.7	6.8
Payout ratio	33.0	43.0	35.0	35.0	35.0
DuPont analysis					
Net profit margin (%)	29.9	42.9	8.6	6.5	5.0
Revenue/Assets (x)	1.0	1.3	0.6	0.6	0.6
Assets/Equity (x)	1.5	1.3	1.2	1.2	1.3
ROAE (%)	57.0	88.9	6.5	4.5	3.6
ROAA (%)	34.7	66.9	5.3	3.7	2.9
Liquidity & Efficiency					
Cash conversion cycle	57.2	38.5	62.0	40.1	37.8
Days receivable outstanding	54.9	33.8	48.6	31.7	30.1
Days inventory outstanding	60.3	51.1	44.8	28.2	25.9
Days payables outstanding	58.1	46.4	31.5	19.8	18.2
Dividend cover (x)	3.0	2.3	2.9	2.9	2.9
Current ratio (x)	2.3	4.4	4.7	4.4	4.0
Leverage & Expense Analysis					
Asset/Liability (x)	3.0	5.1	5.5	5.3	4.9
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)	nm	na	na	na	na
Debt/EBITDA (x)	0.4	0.1	0.7	1.2	1.6
Capex/revenue (%)	4.9	3.3	8.0	8.4	7.9
Net debt/ (net cash)	(534.5)	(2,320.0)	(2,749.7)	(2,791.7)	(2,794.3)

Source: Company; Maybank IBG Research

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