

Malaysia Gloves Sector

NEGATIVE [Unchanged]

Daunting outlook

Current rally may not sustain

While Covid cases may surge with the re-opening of China's borders, this may not lead to significant improvement in earnings for glove makers due to their plant utilization rate which may stay low at the current <50%. Any increase in orders could be easily absorbed, we believe. We maintain our NEGATIVE stance on the glove sector and our view that the recent rally in glove stocks will not sustain. Stock prices will eventually converge to fundamentals. Maintain SELL on TOPG MK, HART MK and KRI MK.

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Covid-19 impact could be overplayed

Sentiment on glove stocks has turned positive lately in anticipation of surging Covid cases with the re-opening of China borders. Nevertheless, the rally may not sustain as the re-opening may not result in upsurge in Covid cases (and hence, the demand for gloves) as: i) herd immunity and the growing list of countries imposing Covid rules on Chinese arrivals may help to curb the spread of Covid cases, ii) there is availability of vaccine boosters, iii) end users like government hospitals' gloves inventory remain high and can last another 5-6 months, and most importantly, iv) any increase in glove demand should be well absorbed as the industry has excess capacity with low plant utilisation rate of <50%. Our checks with glove makers revealed that there has been no notable increase in orders yet.

Our reservations on sector recovery in 2024

Major Malaysian glove players expect demand (DD) and supply (SS) to rebalance by end-2023 after restocking activities resume in June 2023, to be followed by the normalization of glove demand in 2024. We, however, have our reservations (especially after the influx of Chinese glove makers) as the DD-SS projection by the local glove makers is predicated on the existing supply situation before factoring in the resumption of/any potential capacity expansion.

Losing their dominant position; maintain NEGATIVE

Despite being the largest glove maker in the world, TOPG's inability to raise its ASP by 5% in 4Q22 gives a negative signal - TOPG and Malaysia's glove manufacturing sector as a whole appear to be losing their historical dominant position to China's glove makers. We believe strong balance sheets and cost efficiency are important factors that will help the glove makers to weather through the downturn and provide some financial cushion amid a prolonged sector downturn. Among the glove makers under our coverage, HART has the strongest balance sheet with 52 sen/sh net cash, followed by KRI (47 sen) and TOPG (0.04 sen).

Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
Top Glove	TOPG MK	1,632	Sell	0.87	0.35	(59)	28.0	nm	1.0	1.1	1.5	0.0
Hartalega	HART MK	1,269	Sell	1.62	1.43	(10)	5.1	53.4	3.2	1.1	11.7	1.1
Kossan Rubber	KRI MK	631	Sell	1.08	1.03	(4)	15.1	24.6	0.7	0.7	2.3	1.4

2022 review

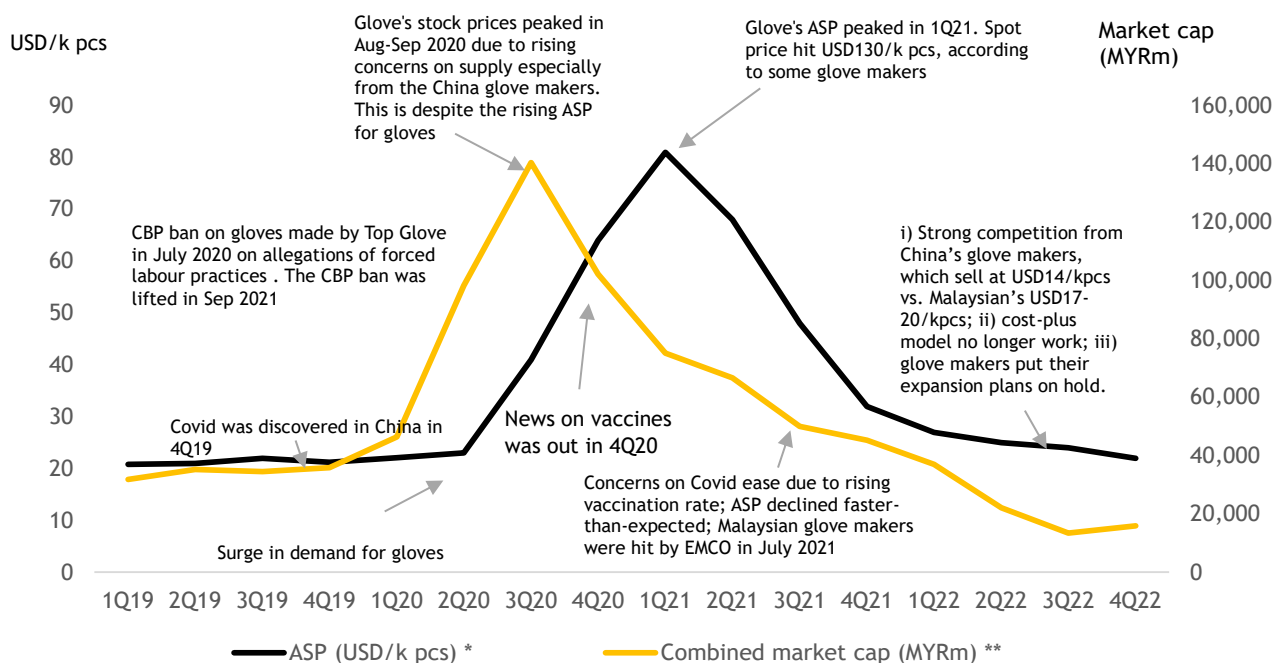
Glove makers' expectation of a sector recovery by mid-June 2022 did not materialize. Share prices of glove players under our coverage continued to plunge by -37% to -68% in 2022 after a spate of dismal glove makers' earnings on stiff competition that led to lower ASPs (-60% YoY) and plant utilization rates (to 35-50%).

Earnings have also been hit by rising production costs (raw materials, manpower and energy as well as compliance costs) with glove makers unable to fully pass-on the higher costs to customers due to the stiff competition. The cost-plus model that was widely used pre-Covid is no longer workable in this market. In Sep 2022, TOPG announced its plan to raise ASP by 5% due to rising operating costs but the initiative was unsuccessful, and TOPG's plant utilization rate fell further from 40-50% in 1QFY8/22 to 25%/30% (on total/effective capacity) in 1QFY8/23. Due to the low plant utilization rate as well as ASP, TOPG reported losses in 4QFY22 for the first time since its IPO listing in 2001 and its losses widened to MYR168m in 1QFY23. As for HART and KRI, we expect losses in the upcoming quarterly results given their low plant utilization rates of 40-50%.

Outlook: A longer and deeper downturn

Given the tough operating environment where the demand-supply rebalancing is unlikely to happen over the medium term, both Malaysian and Chinese glove makers (Intco Medical Technology; 300677 CH; Not Rated) have decided to put their capacity expansion plans on hold. TOPG has even halted its dividend payment to preserve cash and switched its focus from profitability to cash flow. It has lowered its ASP (to below USD20/k pcs) to secure sales and raise plant utilization rate. To optimize cost structure, glove makers are also temporarily shutting down old/inefficient factories. Elsewhere, HART is looking to expand its distribution business (medical products) to diversify its income sources.

Figure 1: Combined market cap (MYRm*) and ASP trend (USD/k pcs**)

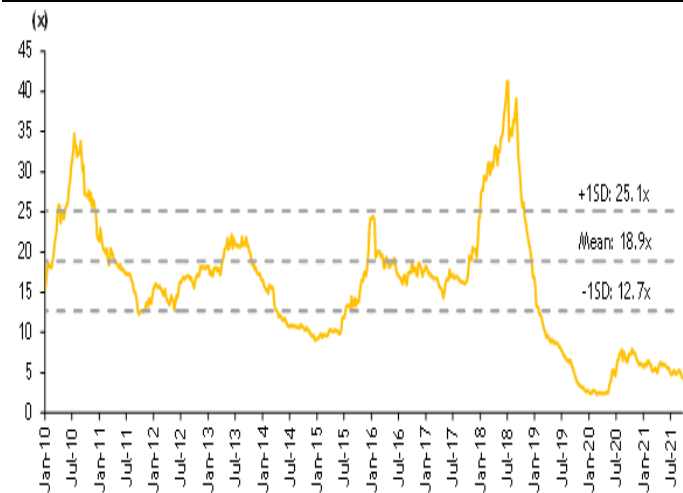


Source: **TOPG, *combined market cap for TOPG, HART and KRI, Maybank IBG Research

Upside risks

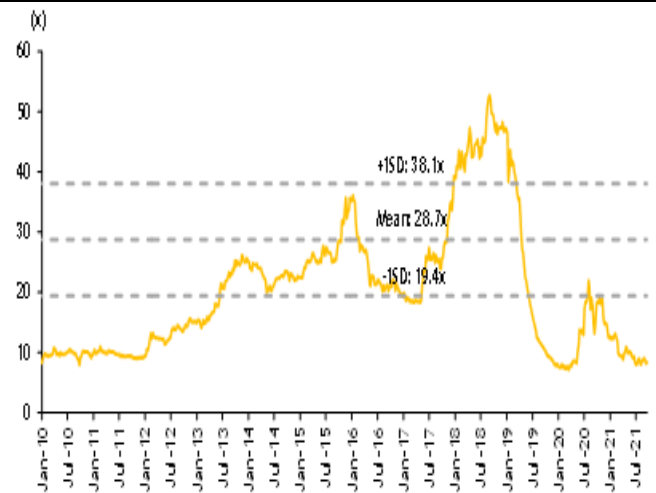
(i) Raw material prices declining faster than ASPs, (ii) higher demand/ consumption for gloves from non-healthcare industries post pandemic, and (iii) new players ceasing operations/exiting the industry sooner than expected, resulting in reduced supply.

Figure 2: Top Glove’s 1-year forward PER (2014-2018; pre-Covid-19)



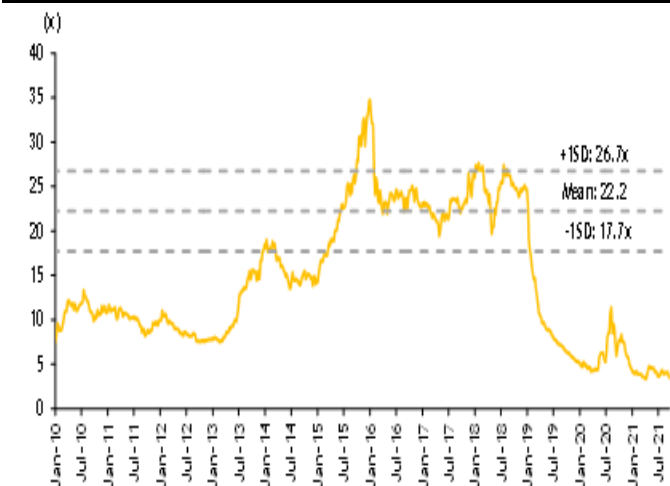
Source: Maybank IBG Research

Figure 3: Hartalega’s 1-year forward PER (2014-2018; pre-Covid-19)



Source: Maybank IBG Research

Figure 4: Kossan’s 1-year forward PER (2014-2018; pre-Covid-19)



Source: Maybank IBG Research

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