

SECTOR UPDATE

Rubber Gloves – Malaysia

Vaccine Fears Overplayed As Demand Is Firmly Intact

2Q20 results are only a prelude to windfall earnings ahead. From now through to Oct 20, we expect steeper-than-expected ASP rise of 30% mom. Meanwhile, ASPs of latex gloves are expected to narrow on its 50% discount to nitrile gloves in the quarters ahead on supply-capped nitrile gloves. Maintain OVERWEIGHT on the sector as we believe the risk-reward trade-off remains attractive. Top pick: Top Glove.

WHAT'S NEW

- **2Q20 results round-up.** Sector earnings came in well above expectations. Top-line grew 38.2% qoq on the back of higher volume growth of 12.4% qoq, primarily on Top Glove realising efficiency gains and destocking of inventory. ASPs saw a step change of 24.6% qoq primarily off an 80% rise in Supermax's ASPs as the others saw a marginal gain of 5.0-6.8% qoq. The RM/US\$ was favourable as well, up 3.1% qoq. Sector EBITDA margin improved considerably on: a) significantly higher ASPs; b) higher economies of scale; and c) lower raw materials costs - nitrile (-1.0%) and latex (-6.6%). Against improved margins, core earnings growth outpaced revenue growth, at 198.9% qoq.

2Q20 SECTOR RESULTS SNAPSHOT

(RMm)	2Q19	1Q20	2Q20	qoq % chg	yoy % chg
Revenue	2756.8	3066.4	4239.2	38.2	53.8
EBITDA	424.2	585.2	1521.9	160.1	258.8
Net profit	239.7	367.5	1098.3	198.9	358.3
				qoq ppt chg	yoy ppt chg
EBITDA margin (%)	15.5	20.0	36.9	84.3	137.6
Hartalega	24.2	22.1	33.4	51.3	37.9
Kossan	11.7	15.8	28.2	78.4	140.3
Top Glove	17.7	18.3	27.0	48.1	52.9
Supermax	8.5	24.0	59.0	146.0	594.1
Net margin	8.8	12.7	26.5	109.1	202.3

Source: Respective companies, UOB Kay Hian

ACTION

- **Maintain OVERWEIGHT.** While the vaccine discovery has made good progress, we believe glove demand would remain firmly intact. This is supported by the gradual ramp-up in vaccine production, less-than-optimal efficacy rates (US Food and Drug administration (FDA) only requires 50% efficacy rate for a COVID-19 vaccine) and public hesitance leading to lower adoption of a vaccine. Factoring in the upcoming step change in ASPs and higher spot-sales mix, we expect earnings to surge over the next three quarters to more than pacify concerns over lofty historical valuations. Our 2021 sector net profit is 52% above consensus estimates, leaving ample positive surprises. Furthermore, our normalised valuations based on 2022 suggest support to existing valuations. Hence, the risk-reward trade-off still appears attractive at this juncture.

- **Our top sector pick is Top Glove** for its increasing spot sales and above-industry expansion growth. We also like Kossan as it is: a) playing catch-up with peers in ASP; and b) on track to being included in the FBMKLCI Index as a constituent.

PEER COMPARISON

Company	Ticker	Rec	Price @ 3 Sep 20 (lcy)	Target price (lcy)	Mkt Cap (US\$m)	PE (x)		EV/EBITDA (x)		P/B (x) 2020F	Div Yield (%) 2020F
						2020F	2021F	2020F	2021F		
Hartalega	HART MK	HOLD	13.86	19.50	12,704.6	23.2	24.0	16.2	16.7	14.7	2.4
Top Glove	TOPG MK	BUY	8.37	12.30	17,047.0	11.3	28.5	8.3	19.8	11.4	1.5
Kossan	KRI MK	BUY	14.00	19.50	4,666.4	17.0	14.4	11.4	9.7	9.8	2.9
Sri Trang	STA TB	BUY	27.25	45.50	1,364.9	7.1	7.8	5.3	5.8	1.2	5.1
Riverstone	RSTON SP	BUY	3.72	6.00	2,254.3	21.2	15.9	14.9	11.8	7.9	0.7
Comfort Glove	CG MK	N.R.	4.26	-	633.1	36.3	23.2	21.2	14.9	21.2	0.4
Rubberex	RBRX MK	N.R.	5.39	-	369.6	18.4	14.2	12.0	9.2	12.0	2.4
Average					5,713.7	20.1	18.6	13.3	12.6	11.9	2.0

Note: Supermax is currently on UOB Kay Hian's restricted list and therefore we refrain from publishing forward looking assumptions and investment recommendation
Source: UOB Kay Hian

OVERWEIGHT (Maintained)

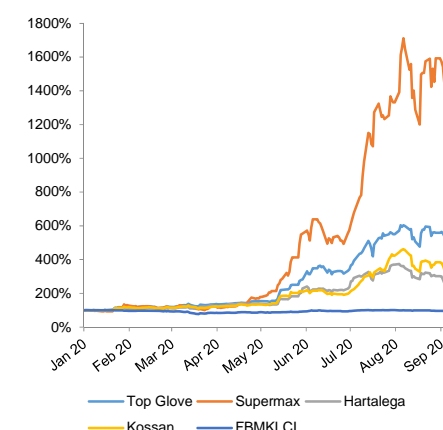
SECTOR COVERAGE

Company	Rec	Price (RM)	
		3 Sep 20	Target
Top Glove	BUY	8.37	12.30
Kossan	BUY	14.00	19.50
Hartalega	HOLD	13.86	19.50

Source: UOB Kay Hian

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YTD PERFORMANCE OF GLOVE PRODUCERS



Source: Bloomberg

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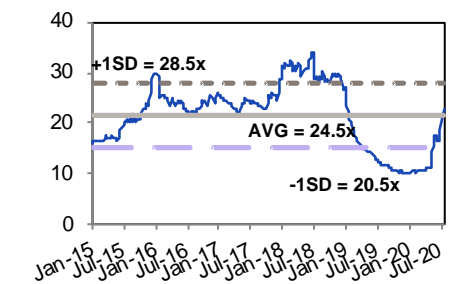
- Top Glove's WRO could be lifted by end of the month.** On 28 Aug 20, Top Glove's independent auditor has completed its verification work with regard to Top Glove's Withhold Release Order (WRO) by the US Customs and Border Protection (CBP). The remediation fee is expected to be about RM53m (or 0.8% of FY21F earnings). We gather that its auditor is due to submit its report over the next few days and subsequently, an uplift of the WRO possibly before Top Glove's 4QFY20 results release on 17 Sep 20. Top Glove has managed to divert sales of the two affected subsidiaries under the WRO to other Malaysian and Thailand subsidiaries, to have largely maintained sales. US sales post WRO has only declined by virtue of higher demand elsewhere. While the WRO financial impact has been minimal, we think investor sentiment could see a boost when the WRO being uplifted.
- Top Glove seeing steeper-than-expected ASP revision.** We gather ASPs have taken a steeper revision through the months to October. They are due to be raised by 30% mom (as opposed to 10% mom), followed by an additional 5-10% mom till year-end. Contracted nitrile ASPs could tip at US\$100/000 pcs by year-end. However, we retain our earnings forecasts for now in the event of ASPs sharply moderating. Hartalega and Kossan could see a lockstep change in ASPs as well.
- Second liners such as Comfort Glove due to reap windfall earnings too.** Based on our channel checks, smaller glove producers such as Comfort Glove (CG MK/NOT RATED) are due to realise steep revisions to ASPs as well. The 30-40% qoq hike seen by the likes of Hartalega and Kossan appears applicable to smaller glove producers like Comfort Glove as well, based on the run rate and an enlarged capacity expansion of 15% in 2020. This suggests its valuation could moderate sharply to a mid- to high-single-digit PE.
- Higher NBR cost on tight supply but limits nitrile glove supply influx.** We gather the nitrile butadiene rubber (NBR) production by the likes of Kumho, Synthomer and LG has reached the limit due to demand driven by glove producers as a component for their nitrile gloves. Additional production capacity for NBR to ease supply is only expected to kick in in late-21. As a result of demand-supply imbalance, NBR cost is expected to rise 5-10% mom. While costlier, it also limits the potential influx of nitrile gloves into the industry, especially from China producers and new entrants. 2020 NBR average cost could be 20% higher yoy and accounts up to 45% of costs for glove producers. This could translate into 5.5% lower earnings for glove producers. However, we leave our earnings forecasts unchanged for now as ASPs have taken a steeper revision.
- Top Pick: Top Glove (TOPG MK/BUY/Target: RM12.30).** Our target price is based on 16.0x 2021F PE, or -2SD of its 5-year forward PE mean. We believe our valuation should be at a discount to its historical PE mean as: a) it is being pegged to windfall peak earnings; and b) the risk-reward at this juncture is increasingly pronounced, given the surge in share price. That said, our PE peg is reasonable as Top Glove is an established FBMKLCI component index constituent and has sublime earnings growth. High spot-sales mix and narrowing latex glove prices to nitrile's may represent further upside surprise to our earnings. These translate into a 2-year CAGR of 313% (FY19-21F). Furthermore, its explosive qoq earnings growth over the next 2-3 quarters should catalyse its valuations going forward.

NOTABLE CAPACITY EXPANSION

	b pcs/ year	yoy % chg	2-year CAGR (2019-21)
Hartalega			
End 2019	35.2	7.2%	
End 2020	40.4	13.3%	
End 2021	43.8	8.4%	10.9%
Top Glove			
End 2019	64.0	11.3%	
End 2020	86.4	35.0%	
End 2021	106.6	23.4%	29.1%
Kossan			
End 2019	29.0	9.4%	
End 2020	32.0	10.3%	
End 2021	35.4	10.6%	10.5%

Source: Respective companies
 Supermax is currently on UOB Kay Hian's restricted list and therefore we refrain from publishing forward looking assumptions and investment recommendation.

TOP GLOVE: 5-YEAR FORWARD PE TRADING BAND



Source: Bloomberg, UOB Kay Hian

EARNINGS ASSUMPTIONS

(RMm)	----- Top Glove -----				----- Hartalega -----				----- Kossan -----			
	2019	Year End (Aug)			2020	Year End (Mar)			2019	Year End (Dec)		
Revenue	4,801.1	6,556.6	14,362.4	9,488.3	2,924.0	5,950.0	6,326.5	4,538.0	2,221.6	3,727.3	4,276.9	3,009.6
yoy % chg	13.9	36.6	119.1	-33.9	3.4	103.5	6.3	-28.3	3.6	67.8	14.7	-29.6
Core net profit	364.7	1,262.2	6,207.7	2,462.2	462.1	2,263.6	2,186.8	903.9	227.3	1,139.2	1,343.3	661.9
yoy % chg	-16.1	246.1	391.8	-60.3	-2.0	388.9	-3.4	-58.6	13.2%	401.2	17.9	-50.7
Consensus		1441.0	3807.0	1545.0		1758.0	1773.0	1174.0		692.7	891.5	550.2
vs Consensus (x)		0.88	1.63	1.59		1.29	1.23	0.77		1.64	1.51	1.20
ASP (US\$/000 pcs)	21.8	25.4	48.1	31.4	22.5	36.6	35.9	26.1	22.1	33.6	36.4	26.1
ASP growth (%)	18.2	16.7	89.0	-34.6	-7.5	62.8	-1.8	-27.5	-5.0	52.0	8.4	-28.5
Volume growth (%)	10.6	11.0	15.9	1.0	8.4	19.6	10.9	-0.5	7.8	9.4	10.5	1.5
Profit margin (%)	7.6	19.3	43.2	25.9	15.8	38.0	34.6	19.9	10.2	30.6	31.4	22.0

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Source: UOB Kay Hian

SCENARIO ANALYSIS ON VALUATIONS

	----- Top Glove -----			----- Hartalega -----			----- Kossan -----		
	PE peg (x)	TP (RM)	ASP (US\$)	PE peg (x)	TP (RM)	ASP (US\$)	PE peg (x)	TP (RM)	ASP (US\$)
Blue sky	16.0	14.30	56.00	29.2	24.10	40.00	18.5	23.60	40.00
TP (peg to FY21)	16.0	12.30	48.05	29.2	19.50	36.61	18.5	19.50	33.61
Normalised (peg to FY22 Dec YE)	30.0	8.30	31.54	40.0	14.50	28.54	26.1	17.70	26.07

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Source: UOB Kay Hian

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