3 September 2020

Outthink. Outperform.

AFFIN HWANG CAPITAL

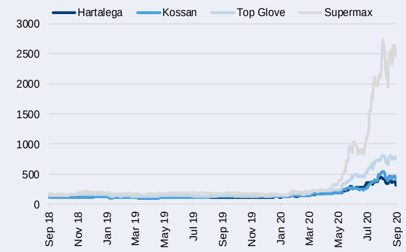
Sector Update

"Earnings have yet to peak, despite achieving record numbers in 2Q20"

Absolute performance (%)

	1M	3M	12M
Hartalega	-32.4	23.5	172.3
Kossan	-24.1	66.7	231.0
Supermax	5.0	184.3	1292.7
Top Glove	-6.6	70.8	433.1

Relative performance (%)



Source: Bloomberg

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Rubber products (Gloves)

Overweight (maintain)

In gloves we trust

- **Maintaining Overweight on the sector, as we believe share prices will continue to re-rate as earnings continue to deliver; Top Glove and Hartalega are our preferred picks for the sector**
- **Despite hitting record profits in 2Q20, the glove companies are still guiding for a stronger 2H20 as ASP is still on an upward trajectory**
- **Share prices have taken a breather due to the news on the vaccines, but we believe it will take some time before vaccines will be made available to the general public, hence demand will likely remain elevated**

Earnings have yet to peak

Although the glove makers under our coverage reported record profits in 2Q20, we believe that they should be able to deliver a stronger performance in 2H20, as they have guided that they are able raise selling prices by around 10%-50% qoq in 3Q20. Given that the current lead times for normal orders have stretched to more than 18 months, we believe that the elevated ASPs can at least sustain until June 2021. Given that new capacity from the new entrants is only likely to start in 2H21, and existing players are already operating at utilization rates of >95%, the overall supply is still insufficient to meet with current demand. The reopening of economies around the world has also spurred demand from the non-medical sectors, like F&B, Retail and Aviation.

Too early to be worried about vaccines

We are not surprised that the share prices for the glove sector have reacted negatively to the news of COVID-19 vaccines. Although the US CDC plans to start distributing vaccines to states starting in November 2020, the overall availability will be relatively scarce and would only be made available to healthcare professionals, essential workers, and those in the high-risk group. Notably, these vaccines have yet to complete Phase 3 trials, and hence it is highly unlikely that they will be made available to the general public. Even with all the healthcare workers immunized against the virus, the usage of gloves is still needed to prevent cross contamination among patients. As such, we are not overly concerned about the impact of vaccines on demand just yet.

New competition unlikely to be a threat for now

Apart from existing players who are in the midst of expanding their capacity to benefit from the current shortage, there are also new players who have expressed their interest in expanding into the sector as well. Based on their plans, most of these new capacities are only likely to start producing by 2H21. Although the FDA does not require the new manufacturers to acquire a 510(k) premarket notification (regulated under Class 1 reserved medical devices) for now, due to the ongoing pandemic, they would still be required to obtain such qualification post the pandemic. We believe these gloves might not be well received by the medical sector, but certainly will be able to meet the needs of the non-medical sector, albeit at a lower price.

Peer Comparison

Company Name	Stock Code	Rating	Share Pr (RM)	TP (RM)	Upside (%)	Mkt Cap (RMm)	Year End	Core PE (x)		Core EPS growth (%)		EV/EBITDA (x)		P/BV (x)	ROE (%)	Div Yield (%)	
								CY20E	CY21E	CY20E	CY21E	CY20E	CY21E	CY20E	CY20E	CY20E	CY21E
HARTALEGA	HART MK	BUY	13.86	28.80	107.79	47,506.6	Mar	31.5	26.0	>100	21.2	22.6	18.6	14.7	48.6	2.0	2.4
KOSSAN	KRI MK	BUY	14.00	22.80	62.86	17,905.1	Dec	23.5	16.8	>100	39.9	17.4	12.4	9.6	40.4	1.7	2.7
SUPERMAX	SUCB MK	BUY	20.30	33.00	62.56	26,215.9	Jun	21.8	19.3	>100	13.0	14.5	12.5	13.2	57.5	1.7	2.3
TOP GLOVE	TOPG MK	BUY	8.37	15.45	84.59	68,015.4	Aug	26.0	17.2	>100	51.1	19.7	13.1	5.4	66.0	2.0	3.1
Average						**159,643.0**		**26.2**	**19.5**	**>100**	**34.8**	**19.2**	**14.2**	**10.7**	**55.1**	**1.8**	**2.6**

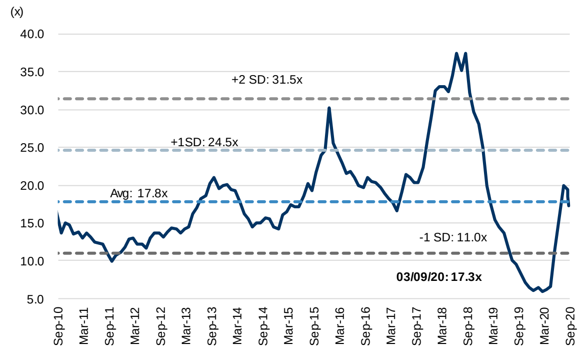
Source: Bloomberg, Affin Hwang forecasts - closing prices as of 03 September 2020
**Top Glove TP have been adjusted for the recent issuance of 2 bonus shares for 1 existing share*

Maintaining Overweight, Top Glove and Hartalega our top BUY picks

We are maintaining our Overweight call on the sector, as we believe that there is still upside to current share prices, while current share prices have not fully reflected the upside from the latest ASP changes. Given that the overall new cases of COVID-19 are still on the rise, and the availability of vaccines for the general public is still a distance, we still see upside risk to our ASP forecast. Our numbers do assume that ASPs will peak by end of 1H21, when a vaccine is available to the general public (similar to the WHO's guidance).

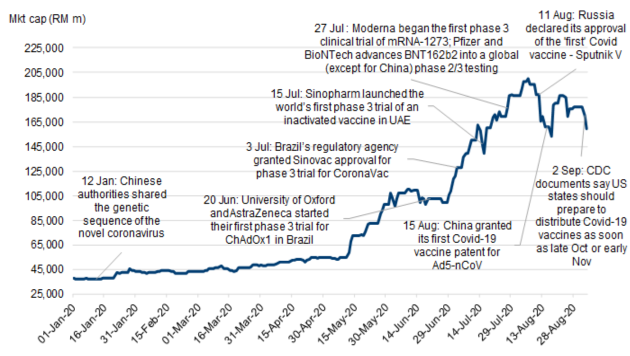
Although we have BUY calls on all 4 glove manufacturers, Top Glove and Hartalega remain our preferred picks for the sector. We like Top Glove due to its exposure on the spot market, and also its role as one of the industry price leaders. For Hartalega, we believe that its earnings in coming quarters would see a sharp increase, as their ASPs were still below market rate in 1H20 given it had locked in its sales prior to the outbreak of COVID-19.

Fig 1: We believe that current valuation for the glove sector is not demanding, trading at around its 10-year historical average



Source: Bloomberg, Affin Hwang

Fig 2: The share prices for the rubber glove sector did take a hit previously due to news on vaccines, but share prices did also recover thereafter

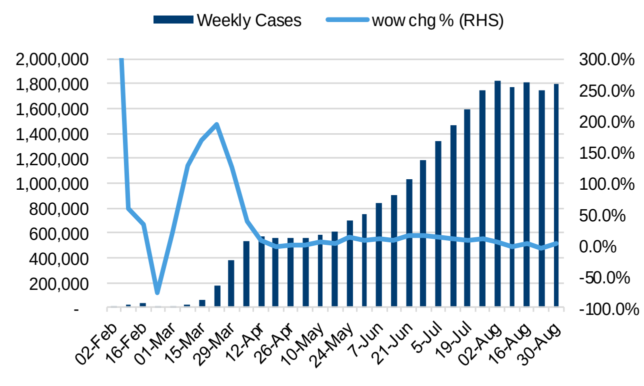


Source: Bloomberg, Affin Hwang

New cases remain elevated

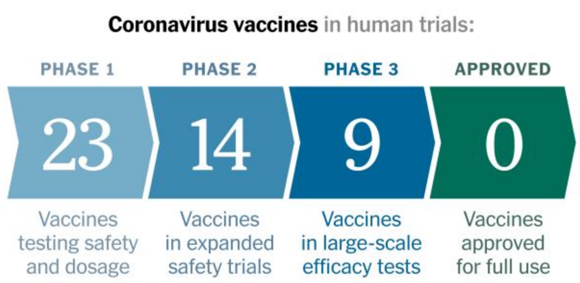
Although the number of reported cases in some of the developed countries like the US and Australia have started to ease as lockdowns and mandatory face-mask rules have been implemented, the overall number of new cases globally still stands at around 1.7m-1.8m/week over the past 6 weeks. We believe that as long as a vaccine is not available to the general public, demand for gloves will remain at elevated levels. While some countries (like the US, China and Russia) have plans to start using the vaccines in coming months, it is only available to certain groups of people, like healthcare professionals, essential personnel and high-risk groups. However, as these vaccines are yet to complete Phase 3 trails, they are unlikely to be available to the general public, as the overall effectiveness and side effects are still unclear.

Fig 3: The overall numbers of news cases of COVID-19 is still on the rise globally



Source: WHO

Fig 4: Currently there are no vaccines that have passed Phase-3 trials yet

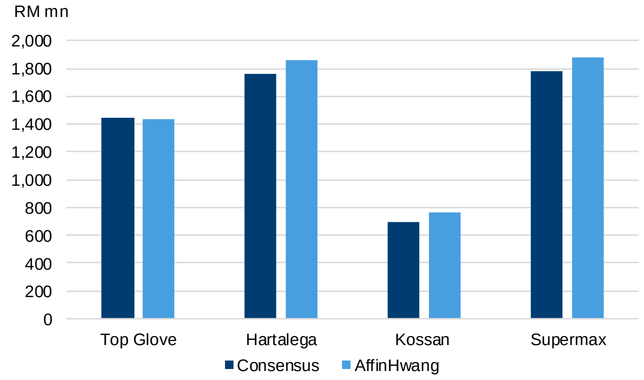


Source: The New York Times, WHO

Guiding for a stronger 2H20

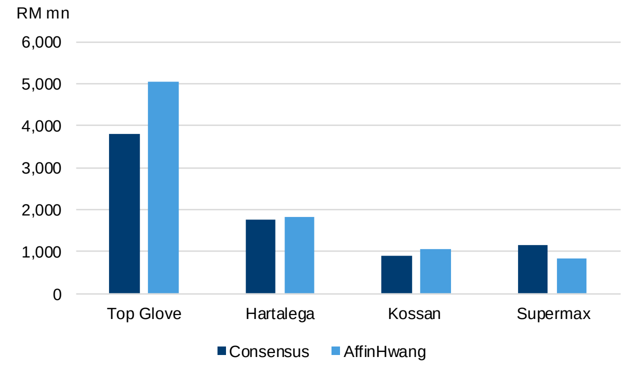
Despite achieving record profits in 1H20, we believe that all the glove manufacturers' earnings have yet to peak, as they are guiding for stronger 2H20 ASPs compared to 1H20. For 3Q20, manufacturers are expected to raise their selling prices by around 10%-50% qoq (5%-18% mom), as there is a spike in demand as the number of cases increased. Given the strong demand, the average utilisation rate for the sector is now at around 95%, and the current lead time for delivery is no less than 18 months. Manufacturers are also allocating more capacity for spot (urgent) orders, which are typically priced 2-3x higher than the normal orders. As we are expecting limited new capacity for the next 6 months, ASPs are likely to remain at elevated levels.

Fig 5: Our earnings forecasts for FY20 are on average 5% higher than consensus



**For Hartalega and Supermax, it is for FY21E*
Source: Company, Affin Hwang estimates

Fig 6: Our earnings forecasts for FY21 are on average 28% higher than consensus

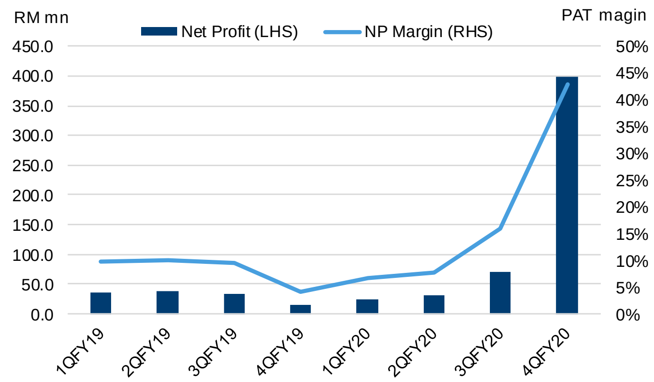


**For Hartalega and Supermax, it is for FY22E*
Source: Company, Affin Hwang estimates

ASPs projected to rise up till end Dec20

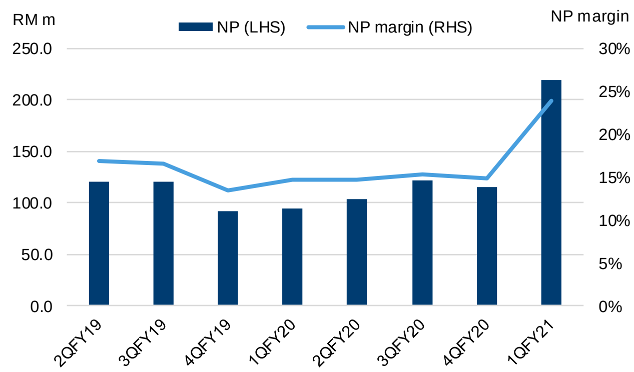
Our key assumption is for ASPs to increase by 5% mom from September until end-December 2020, and to remain flattish throughout 1H21, and then start to decline by 2-3% mom in 2H21. We believe prices would remain flattish in 1H21, as governments around the world would by then have better control on the spread of the virus. However, there could be upside to our ASP assumptions, as there are still spikes in cases in the US and EU (Western Europe) post the reopening of their economies. The earnings growth is not only supported by the increase in ASP, but existing players are still adding new capacity. The overall capacity growth by the Big-4 is around 18% in 2021E. While the reopening of the economy is vital for a country, this could still lead to a "second" or "third" wave for the spread of the virus.

Fig 7: Supermax is able to deliver strong earnings growth in recent quarter, due to the expansion in PAT margin



Source: Company, Affin Hwang estimates

Fig 8: The increase in Hartalega NP margin is not as significant, as they have only started raising its ASP

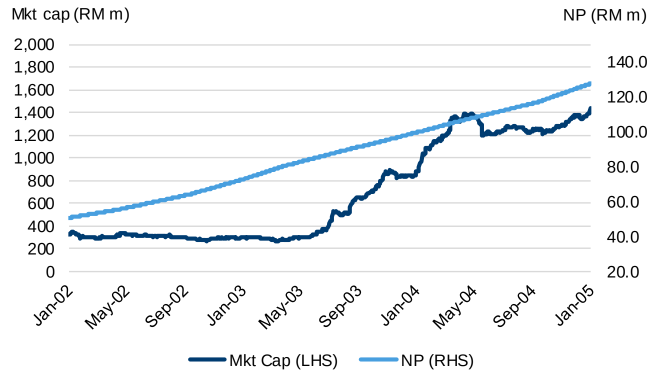


Source: Company, Affin Hwang estimates

Will share prices react similarly to history (post-pandemics)?

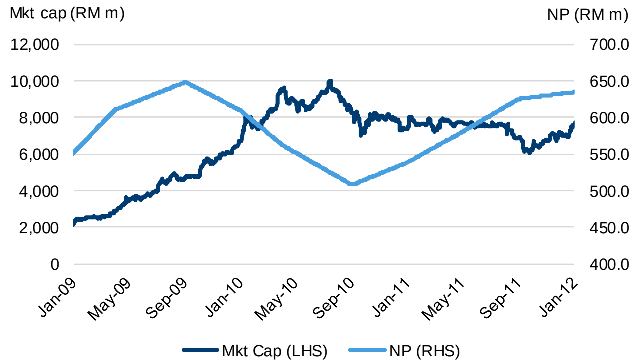
One of the main investor concerns is whether share prices will correct significantly post the COVID-19 pandemic, as earnings are likely to peak after the incremental demand from the pandemic start to wear off. During SARS period (2002-05), we didn't see a huge share price correction post the pandemic, as the manufacturers' capacities were still relatively small, hence they continued to benefit from higher demand (due to change in regulations). Although share prices did correct post-H1N1, it only occurred 9 months after the earnings peak. If the current share price movements were to follow similar trend, as we are only expecting earnings to peak by 2Q21, we believe there is still room for share prices to re-rate.

Fig 9: Share prices for the glove makers didn't correct, as earnings momentum continue post-SARS in 2002-04



Source: Company, Bloomberg

Fig 10: During H1N1 (2009-10), share prices did correct 9 months after earnings peak



Source: Company, Bloomberg

New competition not a threat yet

As existing players continue to deliver strong profitability, we are not surprised by the entrance of new players into the industry, like Karex Bhd (KAREX MK, MK0.86, SELL), AT Systematization Bhd (Non-Rated), GPA Holdings (Non-Rated), Inix Technologies Holdings (Non-Rated), Kanger International (Non-Rated), etc, which have plans to build rubber glove manufacturing plants with capacity of around 0.5bn – 3bn pc/year. Assuming they are able to resolve the labour shortage and utilities problem, they will still need around 12-18 months to complete a greenfield rubber glove plant; hence these new capacities are only likely to be available in 2H21.

Risk to our investment thesis

We believe that the risk to our investment thesis includes: 1) earlier-than-expected availability of COVID-19 vaccines, 2) the increase volatility in forex and raw-material prices, 3) shortage of workers and 4) additional tax on rubber gloves.

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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