

30 April 2024

Consumer Cyclical | Rubber Products

Rubber Products

Overweight (Maintained)

Recovery Remains On Track; OVERWEIGHT

- **Maintain OVERWEIGHT.** The industry's demand and supply dynamics are showing signs of recovery, as April and May order volumes seem to have picked up meaningfully. Further normalisation in gas tariff, coupled with stabilisation of ASPs, can eventually propel glove makers' profitability in 2024. Moving forward, we expect a meaningful demand recovery trend by 2H24 before glove makers recommence capacity expansion in 2025/2026. Key downside risks include weaker-than-expected demand, inability to pass on costs to customers, and higher-than-expected operating costs.
- **Industry dynamics turning favourable.** Industry-blended ASPs are expected to stabilise at USD20/1,000 pieces during the March reporting quarter. We understand customers are more receptive with ASP increase in the coming months as glove makers are likely to undertake a more meaningful price hike in April/May. Chinese glove makers are expected to raise prices to USD16-17 from USD15-16 for the coming months based on our channel checks.
- **Demand expected to pick up by 2Q24.** Malaysia's glove export volume was largely flattish YoY and lower 6% QoQ in 1Q24. Positively, export value grew 5% YoY and 10% QoQ – indicating the momentum of cost pass-through mechanism is picking up. Meanwhile, China glove exports surged 21% MoM following a 15% MoM contraction in February, bringing its 1Q24 QoQ growth to 3%. All in, our 2024 global glove demand forecast is now 375bn pieces, representing 22% YoY growth after we incorporated 2023 data guided by MARGMA (Malaysian Rubber Glove Manufacturers Association).
- **March quarter earnings preview.** We expect glove makers to record slight positive QoQ net profit growth in the upcoming March quarterly reporting season. This is predicated by the pick-up in export value (1Q24: +10%) as well as a stabilised ASP (USD20 per 1,000 pieces) offset against 6% contraction in volume. We expect operating costs to inch up higher in 1Q24, taking into account the latest gas tariff review (+4-5% in January), cost escalations of natural rubber and acrylonitrile prices (+24% and +0.7% QoQ) offset against the strengthening of USD against MYR (+0.5%). That said, we expect Top Glove to continue registering losses for its May reporting quarter given it has the highest exposure in the natural latex glove segment.
- **Moving forward, we expect sales volume to pick up sequentially** in view of a more balanced demand-supply dynamics by 2H24, which in turn should lead to an improvement in glove makers' profitability. With the industry's excess capacity gradually phasing out, we should see its demand-supply equilibrium achieved by end-2024. We also expect price competition risk from Chinese peers to gradually subside, premised on: i) Quality concerns resulting in higher rejection rates from the US Food & Drug Administration (FDA), and ii) Chinese players' pivoting stance towards sustainability. Our sector top picks are Riverstone, Hartalega, and Kossan. Key risks: Decrease in gloves ASP, slower-than-expected demand recovery, lower-than-expected utilisation rate, higher-than-expected raw material price.

Stocks Covered 5
Rating (Buy/Neutral/Sell): 4 / 1 / 0
Last 12m Earnings Revision Trend: Negative

Top Picks

	Target Price
Riverstone (RSTON SP) – BUY	SGD0.93
Hartalega (HART MK) – BUY	MYR3.00
Kossan Rubber (KRI MK) – BUY	MYR2.40

Analysts

Oong Chun Sung
+603 2302 8126
chun.sung@rhbgroupp.com



Singapore Research
research.sg.equity@rhbgroupp.com

ESG scores of rubber gloves companies under our coverage

Company	ESG scores
Top Glove	3.1
Hartalega	2.9
Kossan Rubber	2.8
Supermax	2.3
Riverstone	3.1

Source: RHB

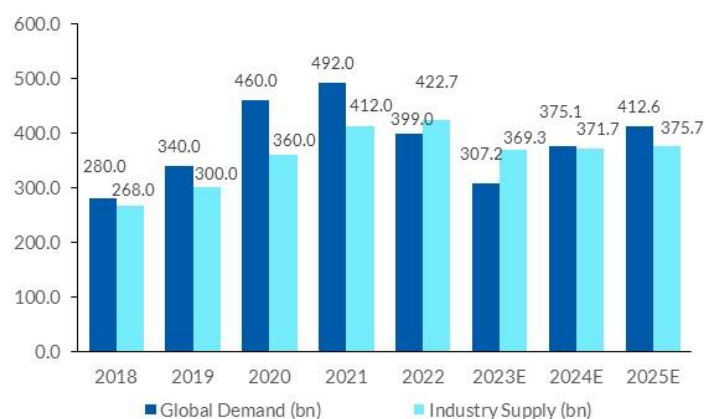
Company Name	Rating	Target	% Upside (Downside)	P/E (x) Dec-25F	P/B (x) Dec-25F	ROAE (%) Dec-25F	Yield (%) Dec-25F
Hartalega	Buy	MYR3.00	12.4	30.1	1.8	6.1	-
Kossan Rubber	Buy	MYR2.40	14.1	26.6	1.3	4.9	1.1
Riverstone	Buy	SGD0.93	17.6	14.1	2.1	15.5	3.6
Supermax Corp	Buy	MYR1.03	25.1	22.6	0.5	2.0	0.9
Top Glove Corp	Neutral	MYR0.83	(0.0)	281.6	1.5	0.5	-

Source: Company data, RHB

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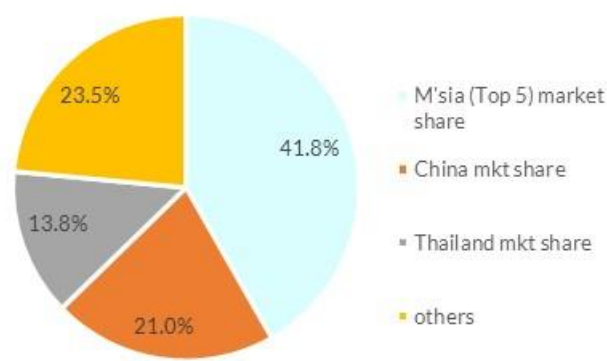
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Figure 1: Gloves' global demand & supply overview



Source: MARGMA, RHB

Figure 2: 2024 Market share by installed capacity



Source: MARGMA, Companies, RHB

Figure 3: Overview of global glove demand and supply (by countries)

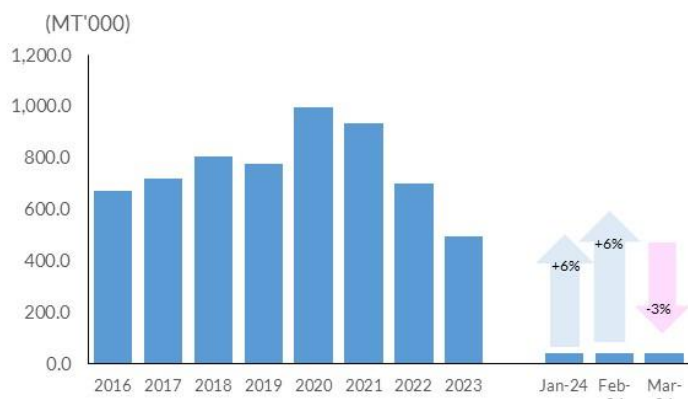
	2019	2020	2021	2022	2023E	2024E	2025E
Global demand (bn)	340.0	460.0	492.0	399.0	307.2	375.1	412.6
YoY		35.3%	7.0%	-18.9%	-23.0%	22.1%	10.0%
Industry supply (bn)	300.0	360.0	412.0	422.7	369.3	371.7	375.7
YoY		20.0%	14.4%	2.6%	-12.6%	0.6%	1.1%
Surplus/(Deficit)	-40.0	-100.0	-80.0	23.7	62.1	-3.4	-36.9
Malaysia top 5 supply (bn)	165.5	195.2	213.2	209.2	153.2	155.2	159.2
YoY	9.4%	18.0%	9.2%	-1.9%	-26.8%	1.3%	2.6%
M'sia (top 5) market share	55.2%	54.2%	51.7%	49.5%	41.5%	41.8%	42.4%
China	25.8	51.6	75.0	75.0	78.0	78.0	78.0
YoY		100.0%	45.3%	0.0%	4.0%	0.0%	0.0%
China market share	8.6%	14.3%	18.2%	17.7%	21.1%	21.0%	20.8%
Thailand	25.0	32.0	40.3	46.2	50.8	51.1	51.1
YoY		27.8%	26.2%	14.6%	9.9%	0.6%	0.0%
Thailand market share	8.3%	8.9%	9.8%	10.9%	13.8%	13.8%	13.6%
Others	83.7	81.3	83.5	92.3	87.4	87.4	87.4
YoY		-2.9%	2.8%	10.6%	-5.4%	0.0%	0.0%

Source: MARGMA, Respective companies, RHB

A more balanced demand-supply dynamic. Following the consolidation period, we estimate that the global glove effective capacity had been reduced by 53.4bn in 2023 (40bn, 13bn, 3bn, and 5bn from Top Glove, Hartalega, Kossan, and Supermax; offset by 3bn in newly added capacity from Chinese glove makers like Intco Medical Technology and 4.6bn in planned capacity expansions from Thailand). We expect marginal change in global industry supply to 2bn planned capacity replenishment by Hartalega (commissioning of NGC 1.5 production line by 2H24) as well as 1.1bn planned capacity by Sri Trang Gloves Thailand.

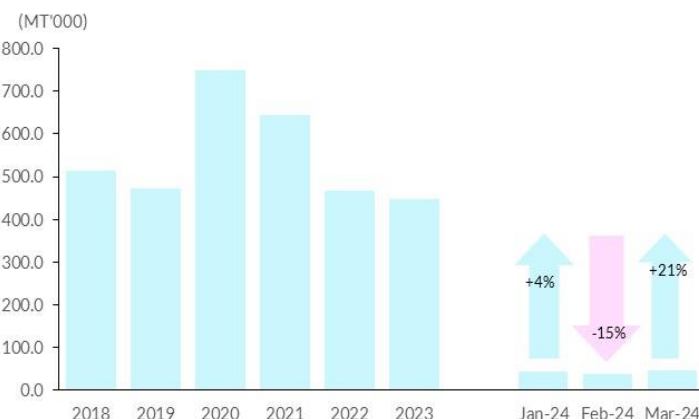
An overview of March export data. Malaysia's glove exports volume contracted 3% MoM in March, bringing its 1Q24 volume to decline 6% QoQ. On a positive note, export value inched up 4% MoM, translating to 10% QoQ growth. Taking cue from the March export data, we believe the lower MoM export volume could be attributed to the difference in product mix shift (higher proportion of high-value goods sold and light-weighted products). Meanwhile, China glove exports were higher 21% MoM following a 15% MoM contraction in February, bringing its 1Q24 QoQ growth to 3%.

Figure 4: Malaysia glove export (in MT)



Source: Department of Statistics Malaysia

Figure 5: China glove export (in MT)



Source: General Administration of Custom of PRC

Competition with Chinese players. We expect the risk of competition from Chinese glove makers to subside gradually owing to: i) expected price hike in April and May (by Chinese makers), ii) less aggressive capacity expansion, and iii) a shift towards improving product quality (as opposed to price competition) as a result of rising quality concerns. YTD, the US FDA has issued thirteen import alerts on companies exporting gloves to the US, with Chinese companies dominating the list (12 out of the 13 companies, with the other from Malaysia).

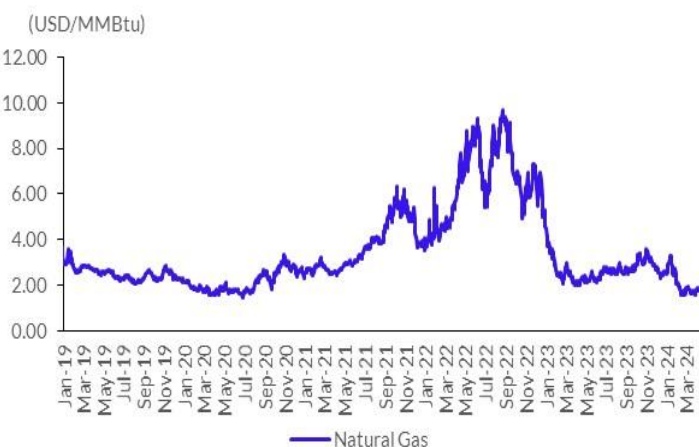
Raw material prices. Natural latex price has gradually come off its peak, closing at MYR1.46 per kg (on 26 April) from its peak of MYR1.62 in mid-March. We expect the price will continue to normalise in May post-winter season. Meanwhile, acrylonitrile prices were largely stable at MYR1.30 per kg, inching up 4% YTD predominantly due to the escalation of feedstock prices, cushioned by a pick-up in production of raw material (ie propylene).

Figure 6: Natural latex and acrylonitrile prices



Source: Bloomberg, RHB

Figure 7: Natural gas prices



Source: Bloomberg, RHB

Valuation and strategy. The sector is currently trading at a compelling forward P/BV of 1.3x, against the pre-COVID-19 5-year mean of 3.5x in view of the potential sectoral earnings recovery by 2024-2025. Our sector OVERWEIGHT call is warranted based on the stabilised ASP trend and restocking activities that are likely to materialise by 2H24 (as demand-supply dynamics are expected to achieve equilibrium).

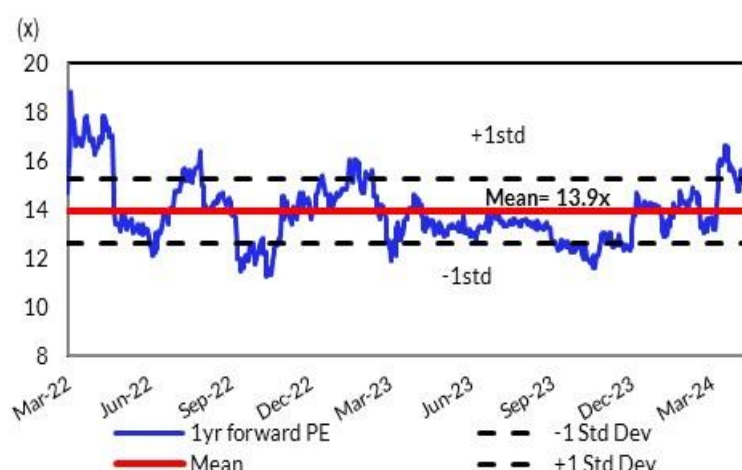
Our Top Picks are: i) Riverstone – thanks to its above peer margin performance, exposure to cleanroom gloves (which should benefit from the recovery of semiconductor sales), as well as its consistent dividend payout; ii) Hartalega – owing to its better operating efficiency among the local glove makers (resulting in better margin and operating efficiency); and iii) Kossan Rubber – for its highest net cash among peers, above-peers average margin profile as well as consistent dividend payout.

Figure 8: Glove sector (ex-Riverstone) forward P/BV band



Source: Bloomberg, RHB

Figure 9: Riverstone forward P/E band



Source: Bloomberg, RHB

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Kossan Rubber (KRI MK)

Buy (Maintained)

Expecting a Decent 1Q24; Still BUY

Target Price (Return): MYR2.40 (14.1%)
Price (Market Cap): MYR2.10 (USD1,124m)
ESG score: 2.8 (out of 4)
Avg Daily Turnover (MYR/USD) 7.32m/1.54m

- **Still BUY, higher MYR2.40 TP (DCF) from MYR2.20.** Kossan Rubber is expected to report its 1Q24 results in May. We expect the company to register a core profit of between MYR30m and MYR35m, representing a flattish to +16% QoQ growth on improving operating dynamics. Our call is premised on a meaningful improvement in market dynamics (by 2H24) and Kossan's consistent dividend payout practices. Our TP incorporates a new 5% ESG discount based on its 2.8 ESG score vis-à-vis the 3.0 country median.
- **Results preview.** We expect Kossan to deliver a core profit of between MYR30m and MYR35m in 1Q24, representing a flattish to +16% QoQ growth on the back of improving operating dynamics, ie cost pass-through mechanism beginning to take place, no recent flare-ups from the Red Sea crisis, improving Malaysia glove exports value, and subsiding competition risks from Chinese manufacturers. That said, we expect a risk of margins compression arising from higher operating costs, ie higher gas tariff review (+4-5% in 1Q24), and cost escalations of natural rubber and acrylonitrile prices (+24% and +0.7% QoQ). This was offset by the strengthening of the USD against the MYR (+0.5%). We expect Kossan continue its dividend payouts in FY24 (with a 30% payout under our assumption).
- **Industry dynamics turning favourable.** We noticed recent operating dynamics have turned in favour of the glove manufacturers, as we understand that customers are more receptive to ASP increases in the coming months. We believe more meaningful price hikes are likely to take place in April and May. Conversely, Chinese glove makers are expected to raise ASPs to USD16-17 per 1,000 pieces from USD15-16 previously for the coming months based to our channel checks. On the demand side, Malaysia's 1Q24 glove exports value surged 5% YoY (+10% QoQ), surpassing export volume growth (flattish YoY, 6% QoQ). This indicates the cost pass-through mechanism's momentum is picking up.
- **Earnings adjustment.** Following a housekeeping exercise, our 2024F and 2025F earnings are raised by 4% each after incorporating figures from Kossan's latest annual report. We also take this opportunity to revise its ESG score to 2.8 from 2.6 after the company demonstrated a reduction in CO2 emission intensity, primarily due to higher renewable energy consumption (ie solar) recorded during the year. Post adjustment, our TP is now higher at MYR2.40 and implies 30x 2025F P/E against its pre-COVID-19 5-year historical mean of 20x.
- **Key risks:** i) Lower-than-expected sales volumes, ii) a weaker-than expected USD against the MYR, and iii) higher-than-expected raw material prices.

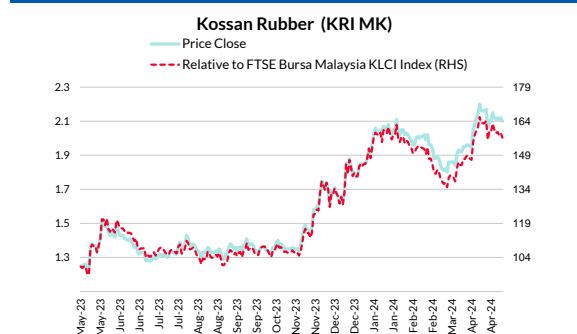
Analyst

Oong Chun Sung
+603 2302 8126
chun.sung@rhbgroup.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	13.5	7.7	(0.5)	55.6	62.8
Relative	5.2	5.3	(5.1)	46.3	51.4
52-wk Price low/high (MYR)				1.22	-2.20



Source: Bloomberg

Overall ESG Score: 2.8 (out of 4)

E: GOOD

Kossan employ a 3R strategy to Reduce, Reuse and Recycle to manage the impacts of pollutants derived from its manufacturing process. The company undertakes energy optimisation initiatives, which includes a transition to solar energy. LED lights and solar-powered perimeter spotlights are also fitted at all factories and offices.

S: GOOD

Kossan adopted an employee pays (zero-cost) policy for its migrant workers recruitment process. Workers are protected from debt bondage, coercion into employment is prohibited, and freedom of movement is allowed. To ensure transparency, employment contracts are make available in the workers' native languages. Potential recruitment agencies are also required to go through an onsite due-diligence audit. This is done together with an independent consultant.

G: GOOD

44% of its board members are independent and 22% are female. This is still below the Malaysian Code on Corporate Governance requirement of 50% independent and 30% female directors. On a positive note, Kossan provides full disclosures on its directors' remunerations. The company also holds regular investor briefings, which embodies good transparency and disclosure practices.

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (MYRm)	2,344	1,591	2,265	2,418	2,487
Recurring net profit (MYRm)	167	33	168	202	235
Recurring net profit growth (%)	(94.2)	(80.1)	406.0	20.1	16.4
Recurring P/E (x)	32.24	161.62	31.94	26.60	22.85
P/B (x)	1.4	1.4	1.4	1.3	1.3
P/CF (x)	57.52	26.49	22.77	17.44	15.25
Dividend Yield (%)	1.2	1.9	0.9	1.1	1.3
EV/EBITDA (x)	13.13	39.18	12.33	10.35	8.75
Return on average equity (%)	3.8	(0.2)	4.3	4.9	5.5
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Malaysia	Recurring EPS	0.07	0.01	0.07	0.08	0.09
Consumer Cyclical	DPS	0.02	0.04	0.02	0.02	0.03
Kossan Rubber	BVPS	1.52	1.50	1.55	1.60	1.67
KRI MK	Return on average equity (%)	3.8	(0.2)	4.3	4.9	5.5
Buy						
Valuation basis	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
DCF FCFF	Recurring P/E (x)	32.24	161.62	31.94	26.60	22.85
	P/B (x)	1.4	1.4	1.4	1.3	1.3
	FCF Yield (%)	(0.4)	2.2	2.5	3.9	4.7
	Dividend Yield (%)	1.2	1.9	0.9	1.1	1.3
Key drivers	EV/EBITDA (x)	13.13	39.18	12.33	10.35	8.75
Earnings forecasts are most sensitive to changes in:	EV/EBIT (x)	22.38	na	18.85	15.00	12.27
i. Improvements in sales volume;						
ii. Positive effect of any changes in the USD/MYR rate;						
iii. Lower nitrile butadiene prices;						
iv. Lower natural rubber prices.						
Key risks	Income statement (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
i. Lower-than-expected sales volumes;	Total turnover	2,344	1,591	2,265	2,418	2,487
ii. A weaker-than expected USD against the MYR;	Gross profit	451	233	311	405	451
iii. Higher-than-expected raw material prices.	EBITDA	314	106	328	377	424
	Depreciation and amortisation	(130)	(113)	(114)	(117)	(121)
	Operating profit	185	(7)	215	260	302
	Net interest	29	42	10	11	14
	Pre-tax profit	204	15	225	271	316
	Taxation	(54)	(18)	(54)	(65)	(76)
	Reported net profit	148	(7)	168	202	235
	Recurring net profit	167	33	168	202	235
Company Profile	Cash flow (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Kossan is one of the world's Big 4 glove makers. It has a production capacity of 33.5bn pieces pa.	Change in working capital	319	64	(39)	(4)	4
	Cash flow from operations	93	203	236	308	352
	Capex	(115)	(87)	(100)	(100)	(100)
	Cash flow from investing activities	(812)	(162)	(83)	(82)	(80)
	Dividends paid	(308)	(64)	(50)	(61)	(71)
	Cash flow from financing activities	(481)	(130)	(57)	(67)	(77)
	Cash at beginning of period	2,558	1,348	1,271	1,367	1,525
	Net change in cash	(1,200)	(89)	95	159	195
	Ending balance cash	1,358	1,259	1,367	1,525	1,720
	Balance sheet (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total cash and equivalents	1,348	1,271	1,367	1,525	1,720
	Tangible fixed assets	1,420	1,364	1,351	1,334	1,312
	Total assets	4,286	4,173	4,440	4,615	4,808
	Short-term debt	77	12	12	12	12
	Total long-term debt	7	5	5	5	5
	Total liabilities	429	339	486	516	540
	Total equity	3,856	3,833	3,954	4,099	4,268
	Total liabilities & equity	4,286	4,173	4,440	4,615	4,808
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	(64.7)	(32.1)	42.4	6.7	2.9
	Recurrent EPS growth (%)	(94.2)	(80.1)	406.0	20.1	16.4
	Gross margin (%)	19.2	14.6	13.7	16.7	18.1
	Operating EBITDA margin (%)	13.4	6.6	14.5	15.6	17.0
	Net profit margin (%)	6.3	(0.4)	7.4	8.4	9.5
	Dividend payout ratio (%)	43.2	(1555.6)	30.0	30.0	30.0
	Capex/sales (%)	4.9	5.5	4.4	4.1	4.0
	Interest cover (x)	43.4	(5.0)	31.7	40.2	47.8

Source: Company data, RHB

Figure 1: DCF valuation

FYE 31 Dec (MYRm)	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	FY32F	FY33F	Terminal
NOPAT	163	197	230	237	244	263	283	302	315	328	
+ D&A	114	117	121	126	131	135	141	148	155	162	
- Change in NWC	(39)	(4)	4	(11)	(12)	(13)	(8)	(24)	(27)	(28)	
- CAPEX	(100)	(100)	(100)	(100)	(100)	(100)	(150)	(150)	(150)	(150)	
Free cash flow to firm (FCFF)	138	211	255	252	262	285	266	277	294	313	6,896
Discount factor	0.96	0.92	0.86	0.80	0.75	0.70	0.66	0.62	0.58	0.54	0.54
PV of FCFF	132	193	219	202	197	201	175	171	169	169	3,719
Risk-free	4%										
WACC	7%										
Terminal growth	2%										
Enterprise value (MYRm)	5,547										
- Minority	(87)										
Cash	1,208										
- Debt	(231)										
Equity value (MYRm)	6,436										
Number of shares (m)	2,552										
Intrinsic value (MYR)	2.52										
ESG											
Premium/(Discount)	-0.12										
TP (MYR)	2.40										

Source: RHB

Emissions And ESG

Trend analysis

Installed 3.16 MWp of solar energy as at 2022. Pledged to reduce carbon emissions via a "reduce and optimise" strategy.

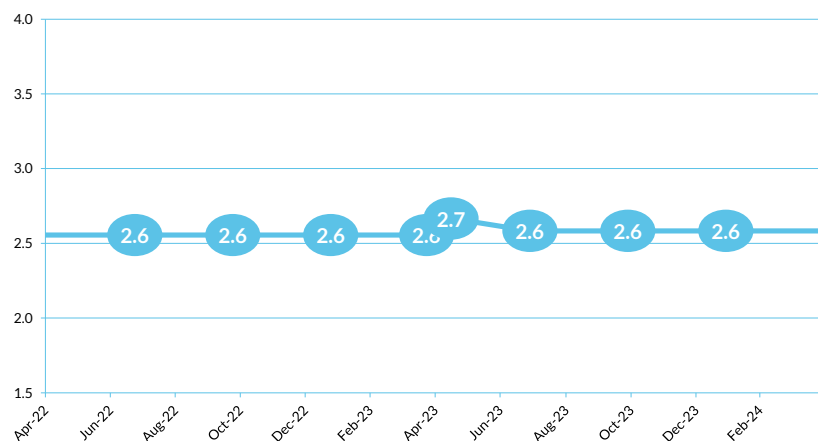
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	382,028	295,547	212,743
Scope 2	130,998	126,020	86,211
Scope 3	-	5,250	5,305
Total emissions	513,026	426,818	304,258

Source: Company data, RHB

Latest ESG-Related Developments

- Introduced a comprehensive carbon accounting system and database, and have improvised greenhouse gas calculation methodology by taking methane (CH₄) and nitrous oxide (N₂O) into consideration when calculating emissions.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-02-23	Buy	2.20	1.96
2024-01-05	Buy	2.20	1.97
2023-11-16	Neutral	1.45	1.58
2023-07-28	Neutral	1.27	1.38
2023-05-15	Neutral	1.27	1.33
2023-04-28	Neutral	1.24	1.25
2023-03-27	Neutral	1.40	1.31
2023-02-17	Neutral	1.08	1.12
2022-11-03	Sell	0.91	1.09
2022-09-27	Sell	0.86	1.00
2022-02-17	Buy	2.05	1.69
2021-12-26	Buy	2.05	1.78
2021-10-22	Neutral	2.38	2.51
2021-09-27	Neutral	2.33	2.27
2021-06-28	Neutral	3.30	3.20

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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KUALA LUMPUR

RHB Investment Bank Bhd
Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 2302 8100
Fax : +603 2302 8134

JAKARTA

PT RHB Sekuritas Indonesia
Revenue Tower, 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

BANGKOK

RHB Securities (Thailand) PCL
10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

SINGAPORE

RHB Bank Berhad (Singapore branch)
90 Cecil Street
#04-00 RHB Bank Building
Singapore 069531
Fax: +65 6509 0470