

16 May 2019

Malaysia

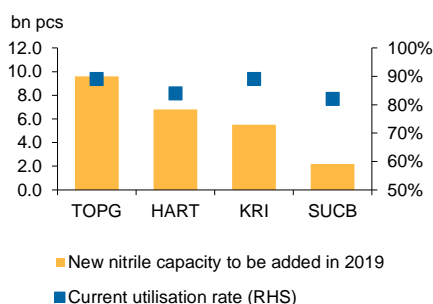
EQUITIES

Quick snapshot of TOPG and HART

	Top Glove	Hartalega
Ticker	TOPG MK	HART MK
Mkt cap (USD mn)	2,935	4,003
Rec.	OP	N
Target price	RM5.02	RM4.32
Price (14 May)	RM4.78	RM4.99
TSR	6.9%	-11%
EPS growth (3-yr CAGR)	9%	5%
PER (CY19E)	26x	35x
Div yield (CY19E)	1.9%	1.7%

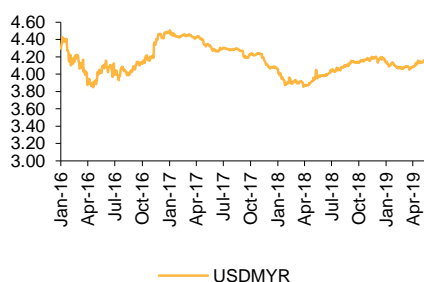
Source: Factsheet, Macquarie Research, May 2019

If US imposes 25% tariff on Chinese vinyl and medical rubber gloves, TOPG is likely to be the largest beneficiary, in our view



Source: Company data, Macquarie Research, May 2019

Stronger USDMYR would benefit the rubber glove sector as 50-60% of its production costs are denominated in Ringgit, while the majority of revenue is in USD



Source: Bloomberg, Macquarie Research, May 2019

Analysts

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Malaysia Rubber Glove

Benefit from US-China trade fight?

Key points

- US hikes tariff from 10% to 25% on US\$200bn worth of Chinese imports; vinyl and medical rubber gloves are excluded, thus the impact is minimal.
- Both vinyl and medical rubber gloves are under the proposed tariff list, however, we think a structural demand shift to nitrile gloves is unlikely.
- We maintain our neutral stance on the sector; prefer Top Glove on margin and earnings resilience and cheaper valuation.

Event

- The trade war between the two largest economies, the United States and China, has intensified after the [US increased the level of tariffs from 10% to 25%](#) on the [previous tariff list](#). We see the impact on this tariff hike to the Malaysia rubber glove sector as minimal as vinyl and medical rubber gloves are excluded. The proposed tariff list will only be finalised by end-June, thus the fundamentals of the sector remain unchanged.

Impact

- Vinyl and medical rubber gloves currently remain tax-exempted.** Our checks show that only nitrile industrial gloves are now being taxed by a 25% tariff as the current higher 25% tariff is only imposed on the [previous final list of goods that was announced in Sep-18](#). Nonetheless, vinyl and medical rubber gloves are now part of the USTR proposed list of goods that is worth another US\$300bn. It would only be finalised at the latest by end-June as the public consultation lasts until June 17 and the public hearing will commence on the same day.
- Immediate impact to glove sector is minimal.** A higher tariff on nitrile industrial gloves is unlikely to swing the market dynamic of Malaysia nitrile gloves as only 5-6% of US-imported non-medical rubber gloves (3-3.5bn pcs/annum) are made by China as compared to Malaysia's total rubber glove export volume of c.160bn pcs.
- Impact may only be meaningful if US imposes tariff on vinyl gloves** as 97% of US-imported vinyl gloves are made by China (Fig 2). The market thinks a narrowed price gap between vinyl and nitrile gloves would cause US buyers to structurally shift to Malaysia nitrile gloves. In this case, we think Top Glove and Hartalega would be the beneficiaries with a blue-sky valuation of RM7.57 and RM8.22, respectively, which is based on a +2STD PER (refer to page 2-3).
- ...however we think it is unlikely to cause a structural/short-term demand shift**, despite having a narrower price gap. This is owing to: i) vinyl gloves are still cheaper with a price discount of 35-53%, ii) sufficient vinyl glove supply in China, iii) the stronger durability feature of nitrile gloves is not necessary for a low-risk task. Additionally, Malaysian glove players also did not benefit last year when vinyl and medical gloves were included on the July-18 proposed tariff list.

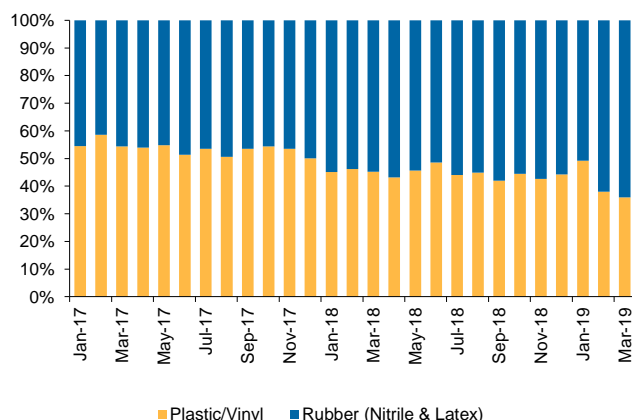
Outlook

- We maintain our neutral stance on the glove sector and keep our forecast status quo, as the proposed list of goods has yet to be finalised. Our preferred pick is Top Glove given its margin and earnings resilience coupled with cheaper valuation. Upside risk to our forecast and target price is a stronger USDMYR. Every 10% change in USDMYR would lift earnings by 14-15% (Fig 10 & 11).

Analysis

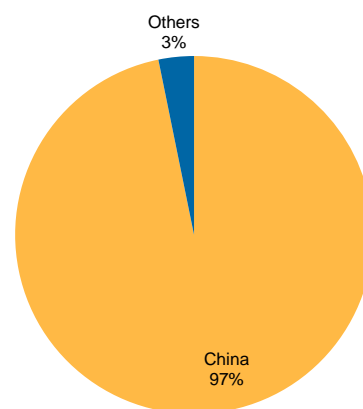
- **Vinyl and medical rubber gloves remain tax-exempted; proposed list still under review.** To-date, only Chinese nitrile industrial gloves are being imposed the higher 25% tariff. Chinese vinyl and medical rubber gloves remain tax-exempted as both are excluded from the finalised tariff list that was released in Sep-18. However, President Trump is looking to add another US\$300bn worth of import goods and both vinyl and medical rubber gloves are part of the list. We understand the United States Trade Representative (USTR) has officially started a public consultation period until 17-June, which means the list will only be finalised at the latest by end-June.
- **Any immediate impact to demand?** The average selling price of Chinese nitrile industrial gloves is similar to Malaysia at US\$19-20/thousands pcs. Although Chinese industrial nitrile gloves are now at least 25% higher than Malaysia, we do not expect this will have any material impact to the market dynamic of the Malaysia rubber glove sector as the US only imports 5-6% of its non-medical rubber gloves (latex and nitrile) from China (3-3.5bn pcs/annum) vs. Malaysia's total export volume of 160bn pcs/annum. In our view, the impact would only be meaningful if the US imposes a tariff on vinyl and medical rubber gloves as c.97% of US-imported vinyl gloves are from China (Fig 2).

Fig 1 United States: import volume breakdown; imported nearly 75bn pcs of plastic/vinyl gloves per year



Source: USITC, Macquarie Research, May 2019

Fig 2 United States: 97% of vinyl gloves are purchased from China



Source: USITC, Macquarie Research, May 2019

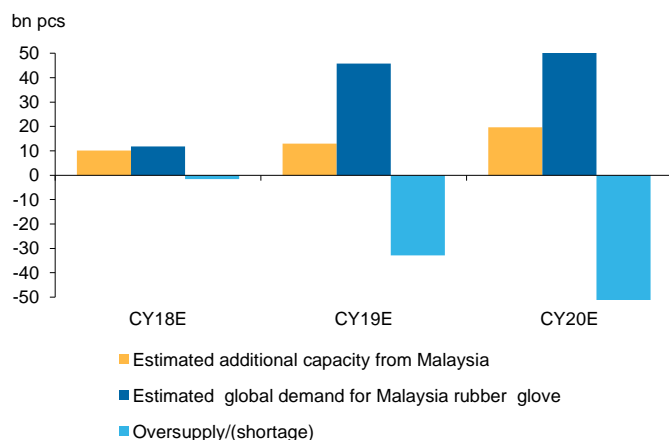
- **Overcapacity risk and price competition would be mitigated if the US imposes a 25% tariff on Chinese vinyl and medical rubber gloves.** The 25% tariff would increase the final import price for the US customer and hence the price discount between both vinyl and nitrile gloves is narrowed from 69%-92% to 35%-53%. Assuming a narrowed price gap triggers a shift from vinyl to nitrile gloves – similar to the shift that happened in 2017, these new demands could easily ease the earlier concerns of overcapacity risk and price competition in the nitrile glove segment. Nitrile gloves are deemed as the closest substitutes for vinyl gloves given both are also latex-free (Fig 3). With the anticipated demand shift and scheduled expansion plans (Fig 5), we expect the concern of oversupply risk in 2019 would be mitigated (Fig 4) and the nitrile market is potentially to experience a shortage in 2Q-3Q19 as most of the new plants only commence in 4Q19 (Fig 5). This indicates to us pricing power would temporarily shift towards glove makers, and hence the margin per glove should start to recover.

Fig 3 Comparison between vinyl, nitrile and latex gloves

Type of glove	Vinyl glove	Nitrile glove	Latex glove
Estimated ASP (USD/000pcs)	12-13	22-23	17-18
Price discount to vinyl gloves		69%-92%	31%-50%
Raw material	PVC resin	32% acrylonitrile and 68% butadiene	Natural rubber latex
Type-1 allergy free (latex protein allergy)	Yes	Yes	No
Flexibility	Looser fit and less elasticity	Fit and puncture resistant	Fit and more elasticity
Barrier protection against infection and contamination	Poor	Good	Good
Purpose	Suitable for short-term and low risk task. i.e. Food handling, household cleaning	Suitable in medical and high-risk task. i.e. Food handling, examination, dental clinics and laboratories	Suitable in medical and high-risk task. i.e. Food handling, examination, dental clinics and laboratories

Source: Macquarie Research, May 2019

Fig 4 Nitrile glove segment would experience a shortage if all the US customers shift from Chinese vinyl gloves to Malaysian nitrile gloves



Source: Company data, Macquarie Research, May 2019

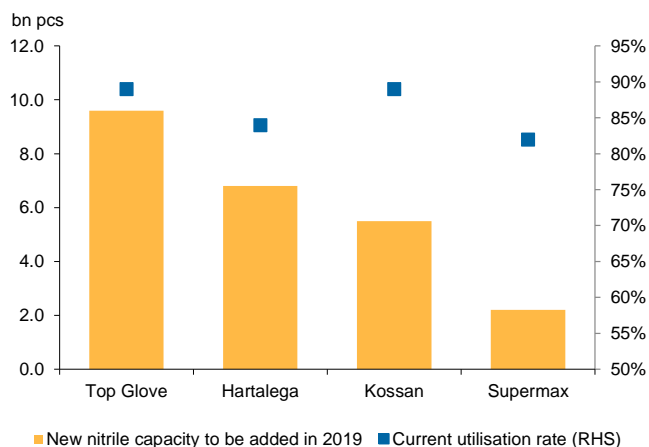
Fig 5 Capacity expansion plan for 2019-2020; most of the Malaysian glove players earlier delayed their expansion plans to 2H19

Company	Type of gloves	Est. installed capacity (bn pcs. p.a.)	Target commencement date
1H19	Top Glove F32 1st phase	Nitrile/latex 2.2	2Q19
	Top Glove F33	Nitrile 1.2	2Q19
	Kossan Plant 18	Nitrile 2.5	2Q19
	Hartalega Plant 5 (remaining 6 lines)	Nitrile 2.1	2Q19
	TOTAL	8.0	
2H19	Top Glove F32 2nd phase	Nitrile/Latex 1.2	3Q19
	Supermax Plant 12	Nitrile 2.2	3Q19
	Hartalega Plant 6	Nitrile 4.7	4Q19
	Top Glove F2	Nitrile 0.8	4Q19
	Top Glove F5A	Nitrile 2.0	4Q19
	Top Glove F40 1st phase	Nitrile 2.2	4Q19
	Kossan Plant 19	Nitrile 3.0	4Q19
	Supermax Sg Buloh	Specialty glove 2.6	Dec-19
	TOTAL	18.7	
2020	Top Glove F40 (2nd phase)	Nitrile 0.8	1Q20
	Supermax Plant 12	Nitrile 2.2	1Q20
	Top Glove F42 (1st phase)	PVC 2.0	2Q20
	Top Glove F8A	Nitrile/Latex 3.2	3Q20
	Top Glove F42 (1st phase)	Nitrile 4.8	4Q20
	Supermax Sg Buloh	Nitrile 1.2	2H20
	Kossan Bidor	Nitrile 4.0	2020
	TOTAL	18.2	

Source: Company data, Macquarie Research, May 2019

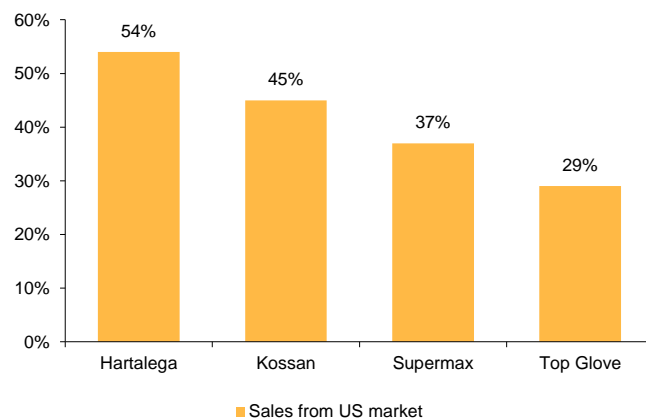
- **Who will be the largest beneficiary?** Among the glove manufacturers, we view Top Glove and Hartalega as being the beneficiaries from the potential structural change in demand. Top Glove has the most additional nitrile glove capacity of 9.6bn pcs/annum (Fig 6) to absorb any potential new demand. While Hartalega's current utilisation rate has declined to 84%, indicating its factories also have spare capacity coupled with its stronger presence in the US market with a 25% market share and 54% of its sales are from the US market (Fig 7).

Fig 6 Top Glove is likely to be the largest beneficiary among other players as it has the most additional nitrile glove capacity in 2019



Source: Company data, Macquarie Research, May 2019

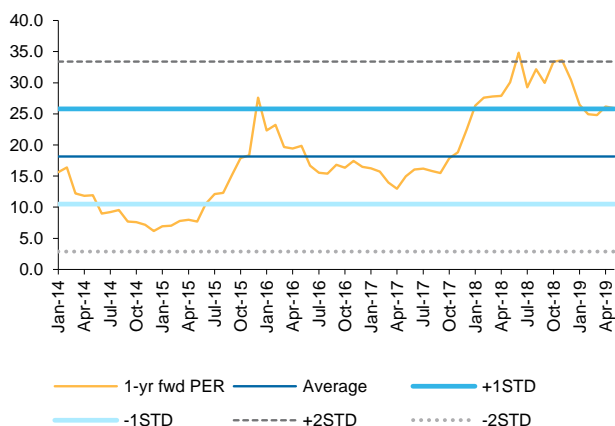
Fig 7 Hartalega has a better presence in the US market given that 54% of its sales are derived from the US



Source: Company data, Macquarie Research, May 2019

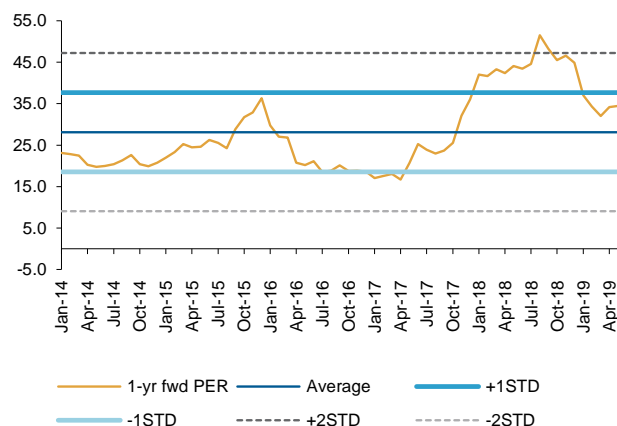
- **Blue-sky valuation:** Historically, we see sector PER multiples spiking to +2STD as a result of an improved earnings outlook which occurred in late-2015 on MYR/USD weakness and late-2017 on a demand shift from vinyl to nitrile gloves. Our analysis of earnings and share prices shows a strong correlation in glove producers' share prices in the period of earnings volatility. Assuming the US imposes a 25% tariff on vinyl gloves and causes demand shifts to Malaysian nitrile gloves, the market dynamic is likely to see a shortage situation and hence both Top Glove and Hartalega's +2STD multiples are likely being retested. **Top Glove** would be worth RM7.57 based on a +2STD PER of 33x, having assumed: i) EBITDA margins improve from the current 16.2% to 16.5%, the level of shortages of nitrile gloves during 2H17-1H18; and ii) its peak utilisation rate of 89%. **Hartalega** would be worth RM8.22 based on a +2STD PER of 47x, assuming: i) EBITDA margin recovers from the current 20.5% to 24.5%; and ii) its peak utilisation rate of 90%.

Fig 8 Top Glove: PER band



Source: Bloomberg, Macquarie Research, May 2019

Fig 9 Hartalega: PER band



Source: Bloomberg, Macquarie Research, May 2019

- **...however we think it is unlikely to happen...** Although the price gap narrowed, we do not think US customers will structurally shift from vinyl to nitrile gloves, underpinned by: i) vinyl gloves are widely used in non-medical sectors, e.g. food handling, which are low-risk tasks and do not require a strong durability glove feature; and ii) the Chinese vinyl glove market has a sufficient supply of vinyl gloves compared to two years ago. Recall that the Chinese government environmental enforcement led to several factory shutdowns, and hence the market experienced a shortage of vinyl gloves in 2017. However, these factories fully resumed their production in 2018. Additionally, we think this proposed list is unlikely to trigger any surge in demand of nitrile gloves as Malaysian makers did not benefit last year when vinyl and medical rubber gloves were proposed to be taxed 10% in July-18.

Fig 10 Top Glove: every 10% change in USDMYR would impact our earnings and valuation by 15%

Δ in USDMYR	Net profit (RMm)			Fair value (RM) based on CY20E 25x PER
	FY19E	FY20E	FY21E	
-0.20	404.4	448.5	524.1	4.63
-0.10	421.4	467.4	546.0	4.82
	438.3	486.3	567.9	5.02
+0.10	455.2	505.2	589.8	5.21
+0.20	472.2	524.2	611.7	5.41

Source: Macquarie Research, May 2019

Fig 11 Hartalega: every 10% change in USDMYR would impact our earnings and valuation by 14%

Δ in USDMYR	Net profit (RMm)			Fair Value (RM) based on CY20E 28x PER
	FY20E	FY21E	FY22E	
-0.20	450.7	483.9	489.4	4.02
-0.10	467.0	501.8	507.8	4.17
	483.4	519.8	526.3	4.32
+0.10	499.7	537.8	544.7	4.47
+0.20	516.1	555.7	563.0	4.61

Source: Macquarie Research, May 2019

Fig 12 Valuation comparison

Name	Bbg Code	Rec.	Price (lcy)	12m tgt (lcy)	Upside (%)	Mkt cap (US\$m)	P/E (x) CY19E	P/E (x) CY20E	P/B (x) CY19E	P/B (x) CY20E	ROE (%) CY19E	ROE (%) CY20E	Div yield (%) CY19E	Div yield (%) CY20E
Top Glove	TOPG MK	OP	4.78	5.02	5%	2,935	26.4	23.4	4.5	4.1	17.7	18.2	1.9	2.1
Hartalega	HART MK	UP	4.99	4.32	-13%	4,003	34.7	32.4	6.9	6.3	20.8	20.4	1.7	1.9
Kossan	KRI MK	NR	3.69	n/a	n/a	1,150	20.0	17.5	3.5	2.7	16.1	17.6	2.0	2.3
Supermax	SUCB MK	NR	1.48	n/a	n/a	500	13.5	12.4	1.7	1.7	13.0	13.8	3.0	3.5
Mkt cap weighted average							28.7	26.1	5.3	4.8	18.6	18.9	1.9	2.1

Closing price as at 14 May 2018, Data for NR stocks is Bloomberg consensus.

Source: Bloomberg, Company data, Macquarie Research, May 2019

Important disclosures:

Recommendation definitions

Macquarie – Asia, USA, Europe and Mazi Macquarie (SA):

Outperform – expected return >10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Australia/New Zealand

Outperform – expected return >10%
 Neutral – expected return from 0% to 10%
 Underperform – expected return <0%

Note: expected return is reflective of a Medium Volatility stock and should be assumed to adjust proportionately with volatility risk

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to select stocks in Asia/Australia/NZ

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 March 2019

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	48.45%	56.50%	47.06%	51.94%	68.53%	51.76%	(for global coverage by Macquarie, 3.69% of stocks followed are investment banking clients)
Neutral	35.27%	30.15%	32.94%	42.78%	24.48%	38.19%	(for global coverage by Macquarie, 2.76% of stocks followed are investment banking clients)
Underperform	16.28%	13.35%	20.00%	5.28%	6.99%	10.05%	(for global coverage by Macquarie, 0.89% of stocks followed are investment banking clients)

Note: This table does not reflect the announced cessation of research services effective April 29, 2019, through our affiliate Macquarie Capital Markets Canada Ltd.

TOPG MK vs KLCI, & rec history



(all figures in MYR currency unless noted)

HART MK vs KLCI, & rec history



(all figures in MYR currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.
 Source: FactSet, Macquarie Research, May 2019

12-month target price methodology

TOPG MK: RM5.02 based on a PER methodology

HART MK: RM4.32 based on a PER methodology

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HART MK: Any inability to compete successfully in their markets may harm the business. This could be a result of many factors which may include geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices. From time to time, the company will enter into transactions, including transactions in derivative instruments, to manage certain of these exposures.

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