


GLOVE SECTOR**Rise in Cases of Respiratory Illnesses among Children in Northern China****Upgrade to NEUTRAL***(Previously NEGATIVE)***DEVELOPMENT**

- According to World Health Organization ("WHO"), China's National Health Commission reported a nationwide increase in the incidence of respiratory diseases, predominantly affecting children in Northern China.
- Chinese authorities attributed this to (1) the lifting of COVID-19 restrictions, (2) the arrival of the cold season, and (3) circulating known pathogens such as influenza, Mycoplasma pneumoniae, respiratory syncytial virus (RSV), and severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2).
- Based on our channel check, the outbreak in China does not suggest a new pandemic. However, precautions are being taken as an early warning sign to prevent the potential emergence of a new pandemic.

OUR VIEW

- We opine that the benefit from the outbreak of respiratory illness in China to Malaysian glovemakers is limited, despite potential higher usage and demand for examination and surgical gloves. This is because local Chinese glovemakers are poised to capitalize on the surge in demand. This is partly attributed to the proximity of their factories in China, allowing them to self-supply and save on delivery time and transportation costs to meet the heightened demand.
- Based on Malaysian Rubber Council ("MRC"), Malaysian exports of rubber products to China accounted for only 6% in 9MCY23. In contrast, Malaysia's primary customers for exported rubber products are from the USA (29%), Europe (17%), and the rest of the world (38%) in 9MCY23. Note that gloves contributed 68.9% to the total export value of rubber-related products in 9MCY23.
- While we do not rule out the possibility of the respiratory illness outbreak spreading to other countries, at this stage, the outbreak is limited to children in northern China. Therefore, we opine that the local glove companies under our coverage may not benefit significantly.
- In 3QCY23, most glovemakers under our coverage reported stronger-than-expected core earnings, with Hartalega and Kossan Rubbers turning profitable during the quarter. This was mainly driven by higher-than-expected sales volume and lower-than-expected operating costs, attributed to reduced raw material costs, natural gas expenses, and production costs per unit (due to the improved sales volume). Meanwhile, Top Glove's core earnings met our estimation, with narrowed net losses in 3QCY23. Overall, the continuous oversupply of gloves in the market caused price-sensitive buyers to demand lower ASP from glovemakers in 3QCY23, given the recent drop in raw material costs (40% of total opex). On a positive note, replenishment activities following the expiry of pandemic inventory led to better sales volumes for all three glovemakers during the quarter. In a nutshell, we upgraded our stock recommendation for all glovemakers from Sell to Neutral in 3QCY23 and expect glovemakers to post positive earnings in 4QCY23.
- **Upgrade Glove sector to NEUTRAL from NEGATIVE.** We upgrade our sector call to **NEUTRAL** from **NEGATIVE** as we see slightly better outlook for the sector. Moving forward, we remain cautious about intense competition from Chinese players, which may exert upward pressure on pricing flexibility for all glovemakers under our coverage. On a positive note, the replenishment of inventory following the expiry of pandemic inventory is expected to boost demand for gloves. This, combined with recent permanent and temporary closures of production facilities, could potentially improve production efficiency and reduce production costs per unit. Our top picks for the sector are **Hartalega (NEUTRAL, TP: RM2.20)** and **Kossan Rubber Industries (NEUTRAL, TP: RM1.38)**. This is primarily based on their effective cost management, and a higher net cash position. 

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MIDF AMANAH INVESTMENT BANK: GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.

ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell

☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology