GLOVE MAKERS COOL TO TRUMP IMPORT TAX

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Glove makers cool to Trump import tax

They say demand will not fall as rubber gloves are vital for the medical sector

by Shalini Kumar

US president Donald Trump's proposed import tax has sent alarm bells ringing across Asian manufacturing countries.

However, major glove makers Top Glove Corporation Bhd and Hartalega Holdings Bhd are well prepared to deal with the aftermath of any US tax on imports.

The tax essentially places a levy on imported goods with the aim of narrowing the trade deficit and making US exports more competitive.

The extent to which a country's trade with the US will be impacted is partly determined by how elastic demand for its products is in the US.

Lim says Top Glove may require customers to absorb the extra cost, or possibly share it

Despite the brave face put on by glove makers, a recent report by Daiwa Capital Markets says Top Glove and Hartalega could see their profit margins affected.

In the report, an analyst notes that Hartalega's gross margin could decline to 23.4% from 28%, while Top Glove's would decrease to 20% from 22.8%, should the companies bear the full burden of their US sales being taxed at 10%.

Key market

For both these companies, the US is a key export market. Top Glove's latest annual report says North America represents 28% of its exports, while it makes up 47% of sales for Hartalega.

The upside, of course, is the competitiveness of the country's glove manufacturers. "Malaysia has cost competitiveness in rubber glove manufacturing due to its proximity to natural rubber supplies. There is no rubber glove manufacturer in the US.

"Also, as rubber gloves are essential medical devices, any significant hike in selling price due to the relocation of production may disrupt the healthcare ecosystem," says Daiwa in its note.

Top Glove executive chairman Tan Sri Lim Wee Chai says should the proposed tax be implemented, the group may require customers to absorb the extra cost, or possibly share it.

Kuan is confident that US demand will not diminish despite any implementation of an import tax

"The extra tax is only a small percentage of total cost. We have to look at the long-term when doing business. Taxes on imports may change anytime and we cannot move our sales based on tax alone.

"Notwithstanding the proposed tax, we also expect that demand will not be impacted as gloves are a necessity in the medical sector and their use is also expanding into other areas such as food handling, where gloves are mandated," he tells ***FocusM***.

Lim says the group is also looking to increase exports to emerging markets where glove usage is rapidly increasing, owing to growing awareness and improving hygiene standards.

Top Glove's Q1 FY17 results saw the group posting a 43% decline in net profit to RM73.3 mil, from RM128.3 mil a year earlier. Revenue for the quarter decreased to RM785.6 mil from RM800 mil.

In a Bursa Malaysia filing, it says the full impact of the 24% natural gas tariff hike and 11% minimum wage increase were also felt in Q1.

Lim says if latex prices continue to rise, the group will have to increase its selling prices.

"This is in line with the industry practice, where both cost increases [from raw material] and cost savings [from lower raw material prices] are shared with customers.

"However, we do not expect to see a decrease in demand arising from higher selling prices as gloves are a necessity in the medical sector, as a result of which demand is relatively resilient," he says.

In Q4 last year, Top Glove raised the average selling price of its latex and nitrile gloves by around 12% and 6% respectively.

Hartalega managing director Kuan Mun Leong is confident that US demand will not diminish despite any implementation of import tax, as he too says rubber gloves are vital for the medical sector.

Higher cost

He also says the proposed tax is not expected to change the group's relationship with the US. "It is not viable for the US to manufacture gloves as it has a higher cost base, especially in terms of labour.

"The US is the largest consumer of rubber gloves, importing close to 30% of world output," he tells ***FocusM***.

For its Q3 ended Dec 31, last year, Hartalega posted a 9% drop in net profit to RM66.2 mil, from RM72.8 mil previously.

This was mainly caused by recognition of an unrealised forex loss on the revaluation of a loan denominated in US dollars and a fair value loss on foreign currency forward contracts.

However, revenue increased to RM456.3 mil from RM398 mil previously. The group also declared a second interim dividend of two sen per share for FY17, ending March 31.

Malacca Securities Research says it has trimmed its earnings estimates for the group for FY17 and FY18 by 14.9% and 4.4% respectively.

This is to reflect the competitive environment of the rubber gloves industry, amid the rising cost of raw materials, labour and utilities.

On the rise of raw material prices, Kuan says as the recent spike is significant, glove manufacturers need to pass on the additional cost to customers.

"We will adjust our selling prices accordingly and expect demand to continue growing at 8-10% per annum," he says.

Challenging year ahead

The second half of this year is expected to be challenging for glove makers as capacity expansion is becoming more aggressive.

"Based on the planned expansion, the new glove supply this year could hit a record high for the industry and potentially lead to intense competition between H2 this year and H1 next year.

"We estimate capacity expansion could chart a record high this year with 17.8 billion pieces, surpassing the peak expansion of 16.3 billion in 2015.

"The bulk of the new capacity will likely start in H2 this year, coming from all key players," notes Maybank IB Research in a report.

At the same time, the exchange rate is expected to weaken, with an average of RM4.20 to US$1, for which Top Glove has the highest exposure, followed by Kossan Rubber Industries Bhd and Hartalega.

TOP GLOVE CORP BHD

KEY BOARD MEMBERS AND MANAGEMENT
TAN SRI LIM WEE CHAI (executive chairman)
LEE KIM MEOW (MD)

MAJOR SHAREHOLDERS	
Tan Sri Lim Wee Chai	29.4%
Firstway United Corp	5.1%
Employees Provident Fund	9.8%

MARKET CAP (Feb 23)	RM6.4b
SHARE PRICE (Feb 23)	RM5.11
52-WEEK HIGH (Feb 23, 2016)	RM5.83
52-WEEK LOW (Aug 24, 2016)	RM4.20

FINANCIAL RESULTS (Q1 ended Nov 30)	
REVENUE	RM785.6m
NET PROFIT	RM73.3m

HARTALEGA HOLDINGS BHD

KEY BOARD MEMBERS AND MANAGEMENT
KUAN KAM HON @ KWAN KAM ONN (executive chairman
KUAN MUN LEONG (MD)

MAJOR SHAREHOLDERS	
Hartalega Industries Sdn Bhd	49.31%
Employees Provident Fund	7.6%

MARKET CAP (Feb 23)	RM7.8b
SHARE PRICE (Feb 23)	RM4.76
52-WEEK HIGH (Feb 23, 2016)	RM5.03
52-WEEK LOW (May 10, 2016)	RM3.81

FINANCIAL RESULTS (Q3 ended Dec 31)	
REVENUE	RM456.3m
NET PROFIT	RM66.2m