TOP GLOVE IN A LUCRATIVE INDUSTRY

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Bigger share: Employees attach latex gloves to an air compressor as other gloves are inflated in the airleak test room at a Top Glove factory in Setia Alam. Top Glove, the world's biggest rubber-glove maker commanding over a quarter of the market, aims to increase its market share to 30 by 2020 via organic expansion and M&As. – *Bloomberg*

New venture offers higher PE valuations and synergy

TAN Sri Lim Wee Chai, the founder of Top Glove Corp Bhd, is convinced that the condom business is a lucrative one to venture into.

Intrigued by his announcement at the company's third-quarter results briefing for the financial year 2017, there was a slew of questions from analysts and the press on his targets for the new business.

The 59-year-old boss of the world's largest rubber glove company must have done his calculations with his team of managers prior to laying out the business plan, one that he says is still at the initial stages, but something that the market has been hearing about for some time.

In a steady tone, he says it’s a flourishing business to expand into since price-earnings valuations for the condom business are higher.

“We are targeting end-2018 to start our production,” he says, adding that up to RM75mil will be ploughed into the two-phase project.

Lim notes that the first phase of this two-phase project entails an initial sum of RM30mil for 10 production lines, followed by 10 more lines in the second phase, which costs RM20mil.

A further RM25mil has been allocated for building the factory as well as land that it had acquired earlier.

While he points out that he is also open to acquiring condom manufacturers, the initial contribution to profits from the potential new venture is expected to be 5%.

“With 20 double-track lines, we estimate a production of two billion pieces per year,” he notes, adding that the new product will fall under the glove maker’s original equipment manufacturer (OEM) business.

A notable entrepreneur who has made his way into Malaysia’s rich list, Lim inherited the family’s rubber planting and trading business – one that has been long viewed as a sunset industry.

But today, Top Glove is one of the top-performing companies on the Main Market of Bursa Malaysia since its listing in 2001. It has been maintaining about a 50% dividend payout ratio for the last few years.

It has booked an average revenue growth rate of 24%, profit after tax (PAT) of 29% and a PAT margin of 9.5% for the past 16 years.

“There is still money to be tapped from rubber.

“A company of our size needs to diversify in order to grow further.

“We also need to set ourselves higher targets in order to keep expanding,” he explains.

To this end, Lim says the company is exploring synergistic mergers and acquisitions (M&As), joint ventures and new set-ups in related industries on a continuous basis.

Similar to his rubber glove business that has flourished over the years, Lim is not aggressive in making acquisitions amid its steady cash flow.

A cautious businessman, he is not in a rush to conclude any deals and the priority remains identifying targets (businesses) with good valuations – one that can immediately contribute positively to the group.

“We will start small, but we are optimistic of the business in the longer term.

“We believe that good business decisions coupled with hard work will see our plans to fruition,” he notes.

Why condoms and not other medical related products?

Lim says the technology used in producing condoms is closely related to its current glove technology. This includes marketing, the production process and raw materials to make the product.

“Demand for this product is growing and the margins are also attractive,” he notes, adding that it only needs to improve the production speed of condoms since it is relatively slower compared to gloves.

Dreaming big

In 2010, Lim ruled out diversification plans into the condom business, saying it needed a different set of skills although technology-wise, it was quite similar.

While the pressure to grow is obvious, Lim is vigilant that being stable is far more pertinent to be in the business.

“Having rubber gloves alone is not enough. Hence, the need for expansion,” he says.

At the recent briefing, Lim echoed plans to be in the Fortune Global 500 list of companies by 2040.

“With over 2,000 customers globally, capturing about 5% of the condom market share will be good enough for us,” he notes.

Top Glove’s world market share for rubber gloves currently stands at 25% and it aims to increase this to 30% by 2020 via organic expansion and M&As.

Just last month, Top Glove went on its acquisition trail.

Its latest corporate development involves its wholly owned unit, GMP Medicare Sdn Bhd, acquiring two rubber glove assets amounting to RM39mil.

This has been viewed positively and a step in the right direction by analysts.

GMP had entered into two separate sale and purchase agreements with A1 Glove Sdn Bhd and Titi Glove Sdn Bhd to acquire two rubber glove assets for the said amount.

“We are looking to capture market share in China, as it offers vast opportunity.

“And the way China is growing, it could be the biggest economy in the world,” he told analysts at the briefing.

Kenanga Research, in its recent report, said the acquisitions further amplified that Top Glove was committed to fulfilling its goal to grow not only organically, but via acquisitions.

“More importantly, these acquisitions allow Top Glove to have a bigger and direct access to the China market,” the research house said, adding that China sales account for 50% of total sales of the two factories.

Essentially, Top Glove can see immediate contributions to its bottom line compared to a green-field rubber glove plant that takes 12 to 19 months to start operations.

Lim believes that with the company’s financial strength, land bank and market size that covers 195 countries, it can achieve its goal to be one of the biggest condom players globally.

“It may take 10 years to scale up to be one of the largest condom manufacturers in the world,” he notes.

Is it up to compete with the bigger condom players such as Karex Bhd?

To this, Lim notes that it is good to have healthy competition in the industry.

“The world’s condom demand is growing every year. There’s room for healthy competition,” he quips.

Challenges in the industry

Karex is the world's biggest condom producer, churning out five billion pieces per year and commanding a 15% share of the global market.

While the overall perception is that gloves and condoms have a similar technology, they are vastly different in terms of target audience, manufacturing process and distribution network, according to Affin Hwang Capital's equity research analyst Aaron Kee.

What are the challenges currently being faced by condom manufacturers like Karex?

Kee says Karex has been in the business for over 20 years but has been facing a few setbacks due to overcapacity in condom supply, as well as reduced volume demand due to funding cuts recently.

This explains why Karex's earnings have been uninspiring in the last few quarters.

While Karex has expanded into building its own brand, it's not easy to penetrate the market.

"This is because it takes time to build up brand reputation.

"And it is up against players like Durex, which has been in the market for a longer time," he notes.

Nevertheless, Kee thinks it's definitely a resilient business and there is still demand for the product, as there is still no substitute for it.

However, in terms of impact, he does not think there will be any material impact in the next three years, considering that the safety requirement for condom manufacturing is much more stringent compared to gloves.

“So, if Top Glove’s condom plans do come through, it won’t be materialised very soon,” he notes.

In terms of PE valuations and margins, Kee views the margins for condoms as not as attractive as before.

He is uncertain whether Top Glove’s move to be a pure OEM manufacturer for condoms can derive the kind of premium valuation that Karex is enjoying currently.

However, having established itself as the largest glove maker in the world, Top Glove should be given the opportunity to prove itself, says the analyst. Another analyst, meanwhile, is of the opinion that the manufacturing process for condoms is similar to gloves, and that with Lim at the helm, the company will see the business through since it has always been his plan.

Noteworthy is the fact that expansion into condoms is one of the many development plans that Top Glove is pursuing.

The group has also voiced out ideas to venture into chemicals and packaging materials to move upstream. However, these are still in the early stages and there hasn’t been any definite plans so far.

Lim’s expansion plans in the past have been spotty, which includes a venture into a Sumatran rubber plantation which he acquired in 2012. Lim bought a 95% stake in Pt Agro Pratama Sejahtera for RM22mil, giving it a 60-year concession to plant rubber trees on 30,773ha of land in Sumatra. But due to Indonesia’s new laws that curb foreign ownership of plantations, Lim wants to pare down Top Glove’s stake.

Apart from plantations, Lim has also diversified into property. Along with the Top Glove Tower in Setia City, Shah Alam, the group’s property leasing division has partial ownership of The Icon@Tun Razak, The Mines 2, PJD Tower and several floors of office space in Empire Subang. These are all located in prime areas in the Klang Valley and offer good yield potential.