

07 October 2019

Top Glove Corporation

Competitive Pressure In Latex Gloves

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We are less sanguine on Top Glove's short to medium-term prospects post its 4QFY19 results' briefing. We expect the group's overall profitability to continue facing competitive pressure from low margins latex gloves and slow recovery at Aspion although cushioned by uptick in nitrile demand. TP is RM4.00 based on 25.5x CY20E EPS. Reiterate UP.

2nd consecutive quarterly earnings disappointment explained. TOPGLOV's 4QFY19 post-results' briefing shed some light on the 5% QoQ sales volume decline and flat PBT growth (-1.2%) despite a net profit growth (+7% due to a low effective tax rate of 1.3% vs normalised going forward mid-teens 15%-17%). The lower QoQ sales volume (-5%) was largely due to lower latex powder-free (-12%) and latex powdered (-23%) buffered by higher nitrile (+12%). Demand for nitrile continued to remain solid with nitrile and latex product mix ratio of 46% : 54%.

Note that PBT margin was flat QoQ in 4QFY19 at 6.8% despite higher ASP due to lower profit contribution from natural rubber glove segment due to lower sales volume in latex gloves and a small loss in the vinyl glove segment. This brings 4QFY19 PATAMI to RM80.1m (+7.2%) boosted by a lower effective tax rate of 1.2% compared to 8.6% in 3QFY19. All in, TOPGLOV was impacted by lower volumes sales in latex and further dragged down by competitive pressure leading to lower margins which we expect to last over the next subsequent quarters.

Slow recovery in Aspion. Despite chalking up a PATAMI of RM19.6m at Aspion (largely due a positive tax of RM16.6m attributable to deferred tax), PBT only came in at a miniscule RM3m on the back of <60% utilisation rate. The group has implemented a rationalisation process at Aspion including reduction of manpower from 3k workers to 2k and re-negotiate better average selling prices terms with customers. All in, we still see low risk of Aspion's related impairments.

Leveraging on technology to reduce cost and maintain margin. In an effort to further mitigate rising cost and reliance on manual labour and hence maintain margins, the group is embarking on automation (expected to commence 2HCY20) in three key areas including: (i) an artificial intelligence system to detect and removed defective gloves, (ii) automated warehouse management system, and (iii) automated glove packing system. The group expect to see automation initiatives to bear fruits in FY21.

Intense competition in latex more than offset uptick in nitrile demand. Looking ahead, the keen competition in the latex segment could negatively impact latex gloves margin. Although earnings are expected to be underpinned by uptick in nitrile demand, the group is plagued with competitive pressure from low margins latex gloves (accounts for estimated 50% of product mix) which could offset the gains in the nitrile segment. The robust demand for nitrile gloves has led to longer delivery lead times of between 45 to 50 days as compared to 30 to 40 days previously.

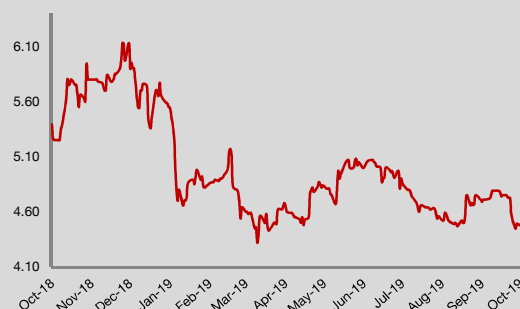
Maintain UP. Our TP is RM4.00 based on unchanged 25.5x CY20E EPS (at +1.0SD above 5-year historical forward mean). Although we expect uptick in nitrile demand to anchor growth in subsequent quarters, the group's overall profitability is facing competitive pressure from low margins latex gloves and a slow recovery at Aspion.

A key upside risk to our call is the better-than-expected margin.

UNDERPERFORM ↔

Price : RM4.48
Target Price : RM4.00 ↔

Share Price Performance



KLCI 1,557.67
YTD KLCI change -7.9%
YTD stock price change -20.0%

Stock Information

| | |
|----------------------|----------------|
| Shariah Compliant | Yes |
| Bloomberg Ticker | TOPG MK Equity |
| Market Cap (RM m) | 11,468.0 |
| Shares Outstanding | 2,559.8 |
| 52-week range (H) | 6.36 |
| 52-week range (L) | 4.30 |
| 3-mth avg daily vol: | 3,829,745 |
| Free Float | 46% |
| Beta | 0.5 |

Major Shareholders

| | |
|--------------------------|-------|
| Tan Sri Dr Lim Wee Chai | 26.8% |
| Firstway United Corp | 7.2% |
| Employees Provident Fund | 6.7% |

Summary Earnings Table

| FY Aug (RM'm) | 2019A | 2020E | 2021E |
|------------------------|--------------|--------------|--------------|
| Turnover | 4801.8 | 5106.3 | 5134.0 |
| PBT | 430.7 | 463.1 | 516.3 |
| Net Profit (NP) | 370.6 | 390.6 | 425.3 |
| Core NP | 370.6 | 390.6 | 425.3 |
| Consensus NP | - | 447.8 | 508.5 |
| Earnings Revision | - | - | - |
| EPS (sen) | 14.5 | 15.3 | 16.7 |
| EPS growth (%) | (15.5) | 5.8 | 8.9 |
| NDPS (sen) | 7.5 | 7.5 | 7.5 |
| BVPS (RM) | 0.95 | 1.07 | 1.15 |
| PER (x) | 30.9 | 29.2 | 26.8 |
| PBV (x) | 4.7 | 4.2 | 3.9 |
| Net gearing (x) | 0.9 | 0.8 | 0.7 |
| Net Div. Yield (%) | 1.7 | 1.7 | 1.7 |

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Income Statement

| FY Aug (RM m) | 2017A | 2018A | 2019A | 2020E | 2021E |
|---------------|---------|---------|---------|---------|---------|
| Revenue | 3409.2 | 4214.0 | 4801.8 | 5106.3 | 4825.6 |
| EBITDA | 502.2 | 702.4 | 706.8 | 672.6 | 736.4 |
| Depreciation | (117.4) | (146.0) | (156.6) | (167.1) | (177.6) |
| PBT | 383.1 | 522.7 | 430.7 | 463.1 | 516.4 |
| Taxation | (50.5) | (85.4) | (57.1) | (69.5) | (87.8) |
| MI | (3.3) | (3.7) | (3.0) | (3.0) | (3.2) |
| Net Profit | 332.7 | 433.6 | 370.6 | 390.6 | 425.4 |

Balance Sheet

| FY Aug (RM m) | 2017A | 2018A | 2019A | 2020E | 2021E |
|-------------------|---------|---------|---------|---------|---------|
| PPE | 1,523.4 | 2,082.2 | 2,463.5 | 2,613.5 | 2,763.5 |
| Subs. & Assoc. | 98.2 | 188.9 | 252.2 | 252.2 | 252.3 |
| Inventories | 315.8 | 513.7 | 615.2 | 654.1 | 618.2 |
| Receivables | 471.3 | 747.6 | 596.5 | 634.4 | 599.5 |
| Other assets | 292.3 | 1,576.8 | 1,562.6 | 1,562.6 | 1,562.6 |
| Cash | 240.1 | 164.2 | 158.8 | 169.3 | 272.0 |
| Total Assets | 2,941.1 | 5,273.4 | 5,648.8 | 5,886.1 | 6,068.0 |
| LT borrowings | 61.8 | 1,359.1 | 1,378.8 | 1,378.8 | 1,378.8 |
| ST borrowings | 314.6 | 854.2 | 1,041.8 | 1,041.8 | 1,041.8 |
| Payables | 419.5 | 485.3 | 518.7 | 551.6 | 521.3 |
| Other liabilities | 128.6 | 159.8 | 266.1 | 162.1 | 162.1 |
| Minorities | 9.2 | 10.6 | 17.1 | 20.1 | 23.3 |
| Net Assets | 2,007.4 | 2,404.5 | 2,426.3 | 2,731.6 | 2,940.6 |
| Share capital | 636.6 | 787.7 | 788.3 | 788.3 | 788.3 |
| Reserves | 1,370.8 | 1,616.8 | 1,637.8 | 1,943.3 | 2,152.2 |
| Equity | 2,007.4 | 2,404.5 | 2,426.2 | 2,731.6 | 2,940.6 |

Cashflow Statement

| FY Aug (RM m) | 2017A | 2018A | 2019A | 2020E | 2021E |
|----------------|---------|---------|---------|---------|---------|
| Operating CF | 465.0 | 169.5 | 611.9 | 514.7 | 603.4 |
| Investing CF | (116.3) | (147.4) | (147.9) | (147.9) | (147.1) |
| Financing CF | 111.6 | (473.2) | (358.0) | (341.3) | (338.6) |
| Change In Cash | 460.4 | (451.0) | 106.0 | 25.5 | 117.6 |
| Free CF | 315.0 | 19.5 | 461.9 | 364.7 | 453.4 |

Source: Kenanga Research, Bursa Malaysia

Financial Data & Ratios

| FY Aug (RM m) | 2017A | 2018A | 2019A | 2020E | 2021E |
|------------------|--------|-------|--------|-------|-------|
| Growth | | | | | |
| Turnover | 18.0% | 23.6% | 13.9% | 6.3% | 0.5% |
| EBITDA | -9.4% | 39.9% | 0.6% | -4.8% | 9.5% |
| Operating Profit | -12.6% | 42.5% | -8.0% | -1.2% | 10.5% |
| PBT | -13.4% | 36.4% | -17.6% | 7.5% | 11.5% |
| Core Net Profit | -7.8% | 30.3% | -14.5% | 5.4% | 8.9% |

Profitability

| | | | | | |
|--------------------|-------|-------|-------|-------|-------|
| EBITDA Margin | 14.7% | 16.7% | 14.7% | 13.2% | 14.3% |
| Operating Margin | 11.5% | 13.2% | 10.7% | 9.9% | 10.9% |
| PBT Margin | 11.2% | 12.4% | 9.0% | 9.1% | 10.1% |
| Core Net Margin | 9.8% | 10.3% | 7.7% | 7.6% | 8.3% |
| Effective Tax Rate | 13.2 | 16.3 | 13.3 | 15.0 | 17.0 |
| ROA | 7.0% | 8.4% | 8.2% | 11.3% | 18.7% |
| ROE | 17.4% | 19.7% | 15.3% | 15.1% | 15.0% |

DuPont Analysis

| | | | | | |
|----------------|------|------|------|------|------|
| Net Margin (%) | 9.8 | 10.3 | 7.7 | 7.6 | 8.3 |
| Assets T/O (x) | 0.9 | 1.3 | 1.2 | 1.1 | 1.2 |
| ROE (%) | 17.4 | 19.7 | 15.3 | 15.1 | 15.0 |

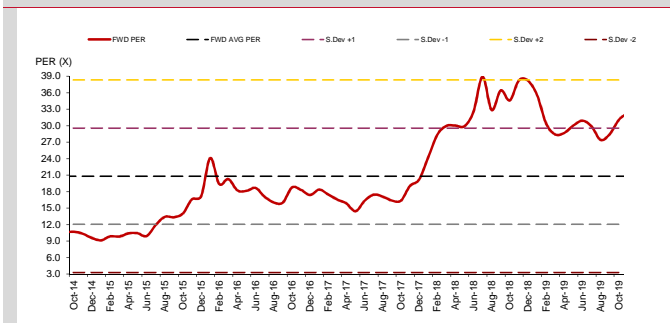
Leverage

| | | | | | |
|-----------------|---------|-------|-------|-------|-------|
| Net cash/(debt) | N. Cash | -2049 | -2261 | -2278 | -2205 |
|-----------------|---------|-------|-------|-------|-------|

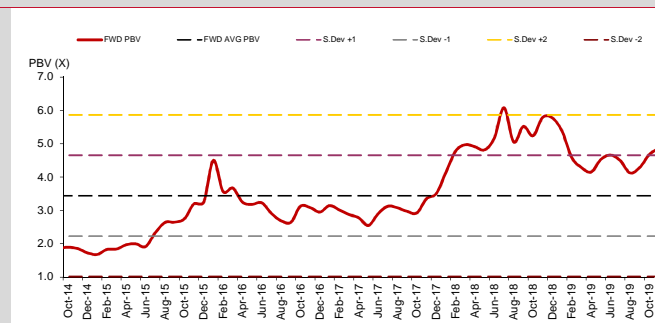
Valuations

| | | | | | |
|-------------|------|------|------|------|------|
| EPS (sen) | 13.4 | 17.0 | 14.6 | 15.3 | 16.7 |
| BVPS (RM) | 1.62 | 0.94 | 0.95 | 1.07 | 1.15 |
| PER (x) | 16.9 | 26.1 | 30.9 | 29.2 | 26.8 |
| Net div (%) | 3.2 | 1.9 | 1.9 | 1.7 | 1.7 |
| P/BV (x) | 2.8 | 4.7 | 4.7 | 4.2 | 3.9 |

Fwd PER Band



Fwd PBV Band



Source: Kenanga Research, Bloomberg

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Peer Comparison

| Name | Last Price (RM) | Market Cap (RM'm) | Shariah Compliant | Current FYE | Revenue Growth | | Core Earnings Growth | | PER (x) - Core Earnings | | | PBV (x) | | ROE (%) | Net Div Yld (%) | Target Price (RM) | Rating |
|--------------------------|-----------------|-------------------|-------------------|-------------|----------------|------------|----------------------|------------|-------------------------|------------|------------|---------|------------|------------|-----------------|-------------------|--------|
| | | | | | 1-Yr. Fwd. | 2-Yr. Fwd. | 1-Yr. Fwd. | 2-Yr. Fwd. | Hist. | 1-Yr. Fwd. | 2-Yr. Fwd. | Hist. | 1-Yr. Fwd. | 1-Yr. Fwd. | | | |
| RUBBER GLOVES | | | | | | | | | | | | | | | | | |
| HARTALEGA HOLDINGS BHD | 5.25 | 17640.0 | Y | 03/2020 | 3.7 | 6.2 | 11.6 | 6.7 | 38.0 | 34.0 | 31.9 | 7.7 | 6.9 | 20.3 | 1.3 | 5.85 | OP |
| KOSSAN RUBBER INDUSTRIES | 4.19 | 5358.7 | Y | 12/2019 | 8.4 | 4.4 | 23.7 | 6.0 | 26.7 | 21.6 | 20.4 | 4.1 | 3.6 | 16.7 | 1.4 | 5.25 | OP |
| SUPERMAX CORP BHD | 1.57 | 2050.9 | Y | 06/2020 | 2.8 | 6.0 | 4.1 | 6.3 | 16.8 | 16.1 | 15.2 | 1.9 | 1.8 | 11.1 | 2.5 | 1.75 | OP |
| TOP GLOVE CORP BHD | 4.48 | 11468.0 | Y | 08/2020 | 6.3 | 0.5 | 5.8 | 8.9 | 30.9 | 29.2 | 26.8 | 4.7 | 4.2 | 14.3 | 1.7 | 4.00 | UP |

Source: Bloomberg, Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

| | |
|----------------|--|
| OUTPERFORM | : A particular stock's Expected Total Return is MORE than 10% |
| MARKET PERFORM | : A particular stock's Expected Total Return is WITHIN the range of -5% to 10% |
| UNDERPERFORM | : A particular stock's Expected Total Return is LESS than -5% |

Sector Recommendations***

| | |
|-------------|---|
| OVERWEIGHT | : A particular sector's Expected Total Return is MORE than 10% |
| NEUTRAL | : A particular sector's Expected Total Return is WITHIN the range of -5% to 10% |
| UNDERWEIGHT | : A particular sector's Expected Total Return is LESS than -5% |

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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