



AmInvestment Bank

Company report

TOP GLOVE CORP

(TOPG MK EQUITY, TPGC.KL)

19 Dec 2018

Higher demand for nitrile gloves

BUY

(Maintained)

Nafisah Azmi

nafisah-azmi@ambankgroup.com

03-2036 2250

Rationale for report: Company update

Price	RM5.74
Fair Value	RM6.35
52-week High/Low	RM6.36/RM3.40

Key Changes

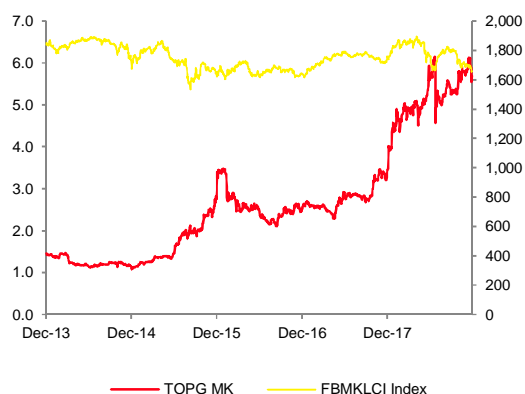
Fair value	↕
EPS	↕

YE to Aug	FY18	FY19F	FY20F	FY21F
Revenue (RM mil)	4,214.5	5,023.0	5,494.5	5,880.6
Core net profit (RM mil)	434.2	471.4	552.7	595.4
FD Core EPS (sen)	17.0	18.4	21.6	23.3
FD Core EPS growth (%)	30.8	8.6	17.3	7.7
Consensus Net Profit (RM mil)		519.0	580.9	646.7
DPS (sen)	17.0	18.4	21.6	23.3
PE (x)	33.8	31.2	26.6	24.7
EV/EBITDA (x)	12.9	10.8	9.4	8.6
Div yield (%)	3.0	3.2	3.8	4.1
ROE (%)	19.8	18.9	20.1	19.6
Net Gearing (%)	43.7	41.4	31.3	26.8

Stock and Financial Data

Shares Outstanding (million)	1,280.2
Market Cap (RMmil)	7,297.3
Book Value (RM/share)	1.60
P/BV (x)	3.6
ROE (%)	17.2
Net Gearing (%)	6.8
Major Shareholders	Lim Wee Chai (28.9%) EPF (6.3%) Firstway United (5.0%)
Free Float	0.6
Avg Daily Value (RMmil)	39.4

Price performance	3mth	6mth	12mth
Absolute (%)	8.6	1.1	71.4
Relative (%)	16.1	6.3	77.7

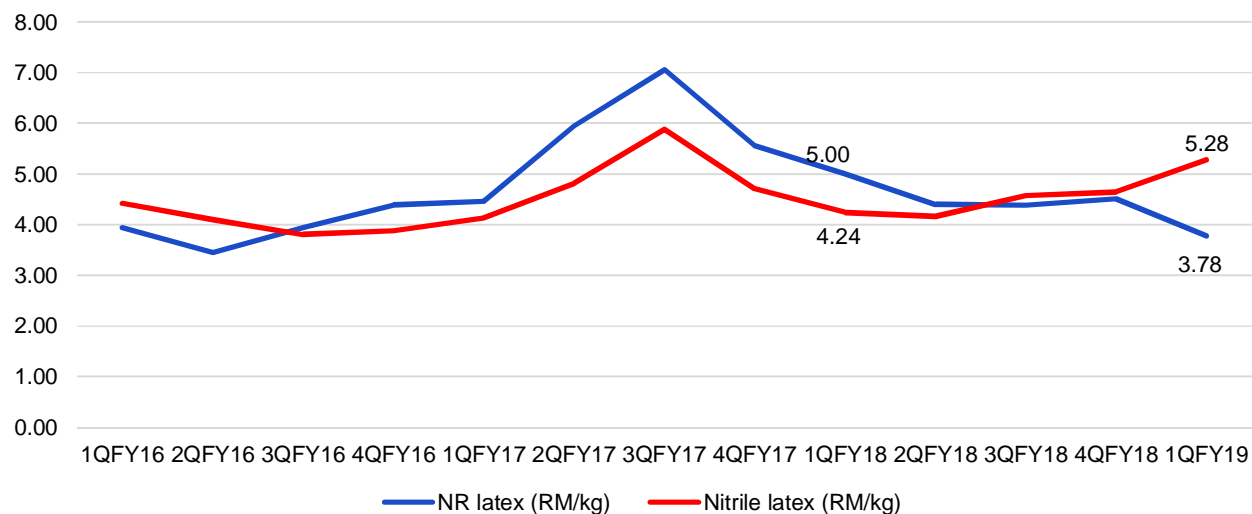


Investment Highlights

- We maintain our BUY call on Top Glove with an unchanged FV of RM6.35/share, based on DCF (at a discount rate equivalent to its WACC of 6.4% and a terminal growth rate of 2.5%). At our FV, the implied CY19F P/E is 16.3x.
- We continue to like Top Glove for: (1) its expansionary plans; (2) focus and continual efforts in improving quality and operational efficiency; and (3) its position as the largest rubber glove manufacturer.
- Key highlights of 1QFY19 results conference call yesterday are:
 1. Top Glove's demand growth is expected to come mostly from developed markets rather than developing markets.
 2. Stronger demand in nitrile gloves saw a bump in the revenue contribution from its nitrile gloves segment.
 3. Proposed bonds issuance by 1QCY19 should improve profitability through reduced interest costs.
 4. Additional expansion plans are in place to achieve a capacity of 75.3bil pieces per annum by 2020 with more focus on nitrile gloves production.
 5. Easing raw material prices will reduce ASPs but with a temporary boost to gross margins initially.
- Top Glove's demand growth came mostly from developed markets rather than developing markets. About 71% of the growth were driven by developed countries such as those in North America, Western Europe and Japan whereas 29% of the growth came from developing countries such as those in Eastern Europe, Asia and Latin America. Moving forward, we believe that the demand growth will be further driven by increased awareness on the importance of hygienic practices in the developing countries.
- Top Glove has seen a stronger demand for its nitrile gloves which made up 41% of sales volume in 1QFY19 (vs. 36% in FY18), resulting in total revenue contribution of 47%. Moving forward, management believes nitrile glove's sales volume will reach 50% of total sales volume. As nitrile gloves' gross margin of circa 17% is slightly smaller compared with natural latex gloves', we believe there will be a slight EBIT margin compression. Also impeding on margins will be Aspion, which contributed 10% to Top Glove's top line but with a negative bottom line contribution.

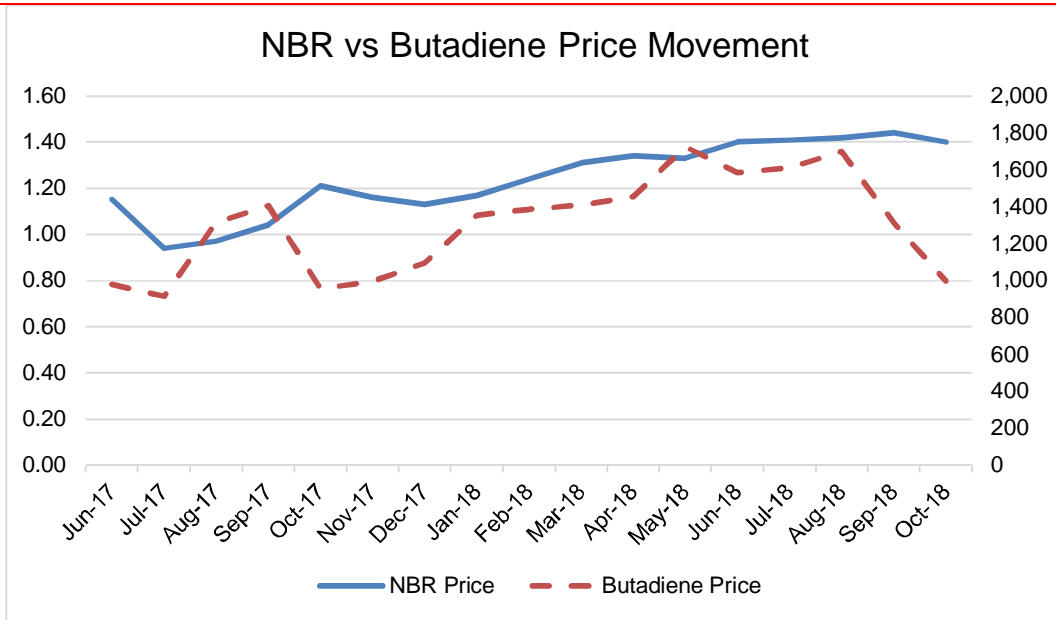
- **Proposed bonds issuance by 1QCY19 would improve profitability.** Management plans to utilize the proceeds from the proposed guaranteed exchangeable bonds issue of up to US\$300mil to pare down its bank borrowings. Based on the illustrative yield of the bonds of 1% per annum, the potential interest savings will be about RM25mil per annum.
- **Additional expansion plans in place to reach a capacity of 75.3bil pieces per annum by 2020 with more focus on nitrile gloves production.** Top Glove has scheduled an expansion plan to increase its production capacity from circa 60.5bil pieces to 75.3bil within 2 years. Management is boosting its nitrile capacity in tandem with growing demand while incorporating increased automation throughout the manufacturing process and facility optimization initiatives to ensure increased efficiency in its plants.
- **Easing raw material prices will reduce ASPs.** Nitrile gloves ASPs increased 11% YoY on the back of higher nitrile latex prices (+25% YoY). However, nitrile prices are expected to decline following the drop in butadiene price as seen in Exhibit 2. Therefore, we believe ASPs for its nitrile gloves will decline but with a temporary boost to margins initially before the cost pass-through mechanism finally kicks in.
- **Moving forward, we believe there could be some pressure on margins in CY19F stemming from the influx of glove supply of the “Big 3” producers (Top Glove, Kossan, Hartalega). CY19F will see an enlarged supply of gloves by 14%, although the expansion will come at a gradual pace. As this exceeds the organic demand growth expectation of 8-10%, we believe ASPs will be weighed down slightly initially. It will take 6-12 months for demand-supply to reach equilibrium.**
- **Top Glove’s earnings is expected to be anchored by capacity-led expansions.** The company’s FY19F earnings will be supported by Factory F32 which is slated to commence production by 1QCY19 and 3QCY19, with 2.2bil pieces and 1.2bil pieces of capacity respectively. We opine that Top Glove is well positioned to benefit from the expected 8-10% growth in demand for rubber gloves for CY19 as it is currently the largest rubber gloves manufacture with circa 26% of market share.

EXHIBIT 1: NR LATEX AND NITRILE LATEX PRICE



Source: Company, AmlInvestment Bank Bhd

EXHIBIT 2: NBR VS. BUTADIENE PRICE MOVEMENT



Source: Company, AmInvestment Bank Bhd

EXHIBIT 3: PB BAND CHART

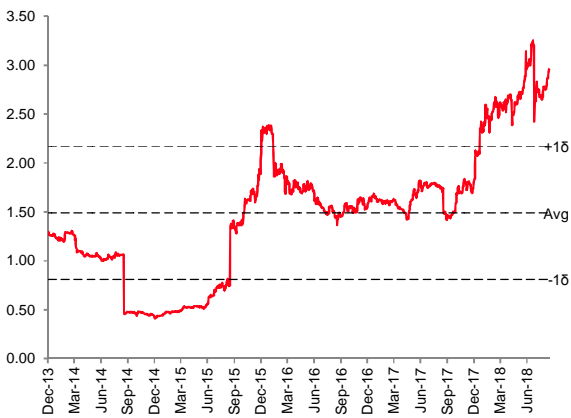


EXHIBIT 4: PE BAND CHART



EXHIBIT 5: FINANCIAL DATA

Income Statement (RMmil, YE 31 Aug)	FY16	FY18	FY19F	FY20F	FY21F
Revenue	2,888.5	3,409.2	4,214.0	5,023.7	5,495.6
EBITDA	522.7	484.2	705.4	870.8	944.4
Depreciation/Amortisation	(107.2)	(111.1)	(161.4)	(206.8)	(221.5)
Operating income (EBIT)	415.5	373.2	544.1	664.0	722.9
Other income & associates	1.3	(1.0)	1.7	-	-
Net interest	25.4	10.9	(23.1)	(51.6)	(45.2)
Exceptional items	-	-	-	-	-
Pretax profit	442.2	383.1	522.7	612.5	677.6
Taxation	(79.8)	(54.7)	(85.4)	(85.7)	(94.9)
Minorities/pref dividends	(1.7)	0.1	(3.7)	0.2	0.2
Net profit	360.7	328.6	433.6	526.9	583.0
Core net profit	360.7	328.6	433.6	526.9	583.0
Balance Sheet (RMmil, YE 31 Aug)	FY16	FY18	FY19F	FY20F	FY21F
Fixed assets	1,239.0	1,606.6	2,246.1	2,964.6	2,950.1
Intangible assets	22.8	22.8	1,271.4	1,271.4	1,271.4
Other long-term assets	46.7	55.5	134.9	134.9	134.9
Total non-current assets	1,308.4	1,684.9	3,652.4	4,371.0	4,356.5
Cash & equivalent	703.2	240.1	357.9	320.2	805.3
Stock	263.7	315.8	513.7	467.0	511.9
Trade debtors	345.7	419.3	671.3	617.9	676.0
Other current assets	24.2	69.3	76.3	76.3	76.3
Total current assets	1,336.7	1,044.4	1,619.3	1,481.5	2,069.6
Trade creditors	332.2	418.8	485.3	750.4	820.9
Short-term borrowings	317.8	314.6	854.2	839.6	825.1
Other current liabilities	40.9	62.3	71.0	71.0	71.0
Total current liabilities	690.9	795.7	1,410.4	1,661.0	1,717.0
Long-term borrowings	81.6	61.8	1,359.1	1,335.9	1,312.8
Other long-term liabilities	50.8	66.3	88.8	88.8	88.8
Total long-term liabilities	132.4	128.0	1,447.8	1,424.7	1,401.6
Shareholders' funds	1,818.0	2,003.3	2,404.5	2,668.0	2,959.5
Minority interests	7.8	9.2	10.6	10.6	10.6
BV/share (RM)	1.46	1.60	1.89	2.09	2.32
Cash Flow (RMmil, YE 31 Aug)	FY16	FY18	FY19F	FY20F	FY21F
Pretax profit	442.2	383.1	522.7	612.5	677.6
Depreciation/Amortisation	107.2	111.1	161.4	206.8	221.5
Net change in working capital	25.6	(52.6)	(279.0)	365.2	(32.5)
Others	(139.2)	(54.1)	(8.7)	(34.2)	(49.6)
Cash flow from operations	435.8	387.4	396.4	1,150.2	817.0
Capital expenditure	(234.1)	(483.1)	(458.4)	(275.0)	(275.0)
Net investments & sale of fixed assets	16.6	20.2	(1,255.4)	-	-
Others	152.1	269.0	9.9	-	-
Cash flow from investing	(65.4)	(193.9)	(1,703.9)	(275.0)	(275.0)
Debt raised/(repaid)	(198.1)	(28.6)	1,471.7	(37.6)	(37.6)
Equity raised/(repaid)	38.9	4.2	12.0	-	-
Dividends paid	(168.8)	(180.9)	(194.6)	(263.3)	(291.3)
Others	29.0	10.9	(27.5)	(51.6)	(45.2)
Cash flow from financing	(299.1)	(194.4)	1,261.5	(352.5)	(374.1)
Net cash flow	71.3	(0.9)	(46.0)	522.7	167.9
Net cash/(debt) b/f	145.2	223.2	240.1	164.2	674.1
Net cash/(debt) c/f	223.2	240.1	181.2	674.1	829.1
Key Ratios (YE 31 Aug)	FY16	FY18	FY19F	FY20F	FY21F
Revenue growth (%)	15.1	18.0	23.6	19.2	9.4
EBITDA growth (%)	15.2	(7.4)	45.7	23.4	8.4
Pretax margin (%)	15.3	11.2	12.4	12.2	12.3
Net profit margin (%)	12.5	9.6	10.3	10.5	10.6
Interest cover (x)	nm	nm	23.6	12.9	16.0
Effective tax rate (%)	18.0	14.3	16.3	14.0	14.0
Dividend payout (%)	36.4	55.4	50.1	50.0	50.0
Debtors turnover (days)	46	41	47	47	43
Stock turnover (days)	33	31	36	36	33
Creditors turnover (days)	42	40	39	45	52

Source: Company, AmInvestment Bank Bhd estimates

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