

18 October 2018

Top Glove Corporation

A Short-Medium Term Setback

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Top Glove's 4Q18 post-results briefing highlighted that management is confident of achieving higher earnings for Aspion over the medium to long-term, given the group's track record, capability, and experience in turning around loss-making glove factories. However, short-to-medium prospects in Aspion could prove a setback due to the irregularities discovered. TP is RM8.85 based on 23x FY19E EPS. Maintain UP.

FY18 results explained, Aspion's earnings dragged down by impact from USD-denominated debt. Top Glove's FY18 post-results briefing shed some light on the 26% YoY sales volume growth and higher YoY net profit growth (+33%). FY18 revenue was driven by higher sales volume (+26%) which grew across the board, led by nitrile (+27%), latex powdered free (+24%), latex powdered (+23%) which more than offset the lower surgical segment (+76%), albeit with a smaller base. In tandem with growing demand, nitrile gloves accounted for 32% of total product mix and continued to gather momentum compared to an average of 25% over the last few quarters. In terms of profitability, FY18 net profit rose 33% YoY due to: (a) higher mix of nitrile gloves and high utilisation rates for both nitrile (90%) and latex (80%) gloves, (b) 20% gas energy savings, which minimised the impact from a 24% gas tariffs hike, and (c) higher ASPs and volume growth. However, excluding Aspion's contribution and funding cost, FY18 revenue only increased by 17% but PATAMI rose to 37% implying that earnings was dragged down by Aspion. We understand that Aspion's lower earnings were dragged down by impact from USD-denominated debt. Excluding currency impact from USD-denominated debt, Aspion contributed 4% or RM17m (6 months contribution) to overall Top Glove's bottom-line in FY18. In terms of geographical markets, volume sales in all markets grew across the board, including Asia (+58%), Western Europe (+35.8%), Eastern Europe (39.6%), Latin America (+21.8%), Middle East (+38.7%) and Africa (+35.3%) continued to dominate overall sales.

Aspion's net profit contribution of RM80m now taking 4 to 7 years. Management is only expecting Aspion's net profit contribution initial target of RM80m now taking 4 to 7 years compared to the initial profit guarantee of RM80-100m (profit guarantee appears less likely following the recent legal case) for FY18 and FY19. We believe this is a setback to Top Glove over the medium term in terms of longer payback period and funding cost incurred for the acquisition of Aspion for RM1.37b.

No impairment charge arising from the acquisition of Aspion. The group has done impairment test from the goodwill of RM1.2b arising from the acquisition of Aspion and no impairment is required. Management assessed the recoverable amount of Aspion Sdn Bhd based on its value-in-use, which in turn is determined based on cash flow projections or discounted cash flow (DCF method, zero terminal growth) of Aspion Sdn Bhd compared to the PER method used in the acquisition. In short, as long as the DCF parameters used for the recent impairment testing is conservative, this reduces the risk of a negative charge provided Top Glove is able to meet its own financial forecast.

Outlook. Looking ahead, Top Glove is in the process of constructing several manufacturing facilities namely, Factory 32 (Phases 1 and 2 to be completed early and end-2019, respectively; 4.4b pieces), Factory 33 (operational by March 2019; 1.2b pieces), Factory 5A (operational by Oct 2019; 2b pieces) and Factory 8A (operational by early 2020; 3.2b pieces) which will boost the Group's total number of production capacity by 9.8b gloves per annum to 69.1b (+14%).

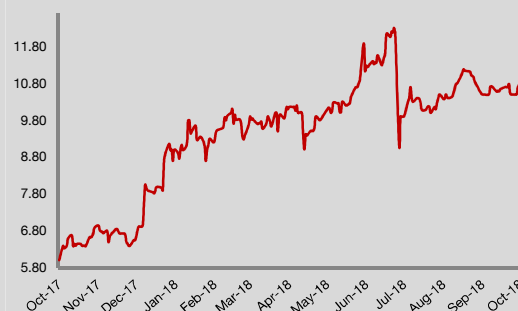
Maintain UNDERPERFORM. TP is RM8.85 based on 23x FY19E EPS (+1.0 SD above 5-year forward historical mean).

A key upside risk to our call is higher-than-expected sales volume.

UNDERPERFORM ↔

Price : RM11.50
Target Price : RM8.85 ↔

Share Price Performance



KLCI	1,740.59
YTD KLCI change	-3.1%
YTD stock price change	43.9%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	TOPG MK Equity
Market Cap (RM m)	14,698.8
Shares Outstanding	1,278.2
52-week range (H)	12.48
52-week range (L)	6.31
3-mth avg daily vol:	3,647,213
Free Float	58%
Beta	0.2

Major Shareholders

Tan Sri Dr Lim Wee Chai	28.9%
Employees Provident Fund	7.3%
KWAP	5.4%

Summary Earnings Table

FY Aug (RM'm)	2018A	2019E	2020E
Turnover	4214.0	4406.8	4607.6
PBT	522.7	637.6	680.9
Net Profit (NP)	433.6	490.2	526.0
Core NP	433.6	490.2	526.0
Consensus NP	443.6	519.7	572.9
Earnings Revision	-	-	-
EPS (sen)	34.3	38.5	41.3
EPS growth (%)	29.3	12.1	7.3
NDPS (sen)	17.0	17.0	17.0
BVPS (RM)	1.89	2.10	2.35
PER (x)	33.5	29.9	27.8
PBV (x)	6.1	5.5	4.9
Net gearing (x)	0.8	0.7	0.6
Net Div. Yield (%)	1.5	1.5	1.5

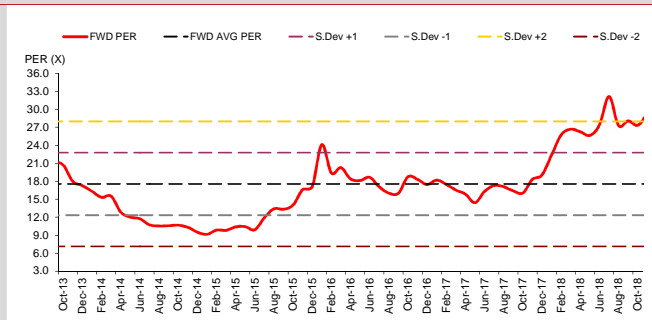


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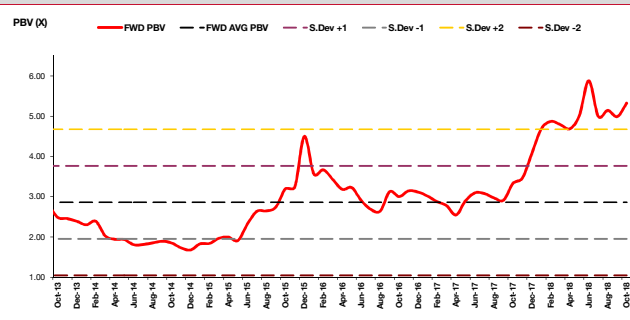
Income Statement						Financial Data & Ratios					
FY Aug (RM m)	2016A	2017A	2018A	2019E	2020E	FY Aug (RM m)	2016A	2017A	2018A	2019E	2020E
Revenue	2888.5	3409.2	4214.0	4406.8	4607.6	Growth (%)					
EBITDA	554.6	502.2	702.4	794.1	848.0	Turnover	15.1%	18.0%	28.1%	0.9%	4.6%
Depreciation	(108.7)	(117.4)	(146.0)	156.6	167.1	EBITDA	16.0%	-9.4%	39.9%	13.1%	6.8%
PBT	442.2	383.1	522.7	637.6	680.9	Operating Profit	17.7%	-12.6%	42.5%	14.6%	6.8%
Taxation	(101.7)	(50.5)	(85.4)	(101.2)	(108.6)	PBT	21.6%	-13.4%	36.4%	13.9%	7.3%
MI	(3.2)	(3.3)	(3.7)	(3.9)	(4.1)	Core Net Profit	28.8%	-7.8%	30.3%	13.0%	7.3%
Net Profit	360.7	332.7	433.6	490.2	526.0						
Balance Sheet						Profitability (%)					
FY Aug (RM m)	2016A	2017A	2018A	2019E	2020E	EBITDA Margin	19.2%	14.7%	16.1%	18.0%	18.4%
PPE	1,124.8	1,523.4	2,082.2	2,232.2	2,382.2	Operating Margin	15.5%	11.5%	12.7%	14.5%	14.8%
Subs. & Assoc.	125.4	98.2	188.9	188.9	188.9	PBT Margin	15.3%	11.2%	12.0%	13.5%	13.9%
Inventories	263.7	315.8	513.7	518.3	542.0	Core Net Margin	12.5%	9.8%	9.9%	11.1%	11.4%
Receivables	368.6	471.3	747.6	754.3	788.7	Effective Tax Rate	23.0	13.2	16.3	17.0	17.0
Other assets	541.3	292.3	1,576.8	1,576.8	1,576.8	ROA	13.1%	7.5%	8.8%	11.9%	18.8%
Cash	224.1	240.1	164.2	284.8	412.7	ROE	21.1%	17.4%	19.7%	19.3%	18.6%
Total Assets	2,647.8	2,941.1	5,273.4	5,555.3	5,891.2						
						DuPont Analysis					
LT borrowings	101.1	61.8	1,359.1	1,359.1	1,359.1	Net Margin (%)	12.5	9.8	9.9	11.1	11.4
ST borrowings	298.3	314.6	854.2	854.2	854.2	Assets T/O (x)	0.9	0.9	1.2	1.3	1.3
Payables	331.0	419.5	485.3	489.6	512.0	ROE (%)	21.1%	17.4%	19.7%	19.3%	18.6%
Other liabilities	91.3	128.6	159.8	159.8	159.8						
Minorities	7.8	9.2	10.6	14.5	18.6	Leverage					
Net Assets	1,818.3	2,007.4	2,404.5	2,678.2	2,987.8	Net cash/(debt)	Net Cash	Net Cash	-2049.0	-1928.4	-1800.5
Share capital	627.4	636.6	787.7	787.7	787.7	Valuations					
Reserves	1,190.9	1,370.8	1,616.8	1,890.5	2,200.1	EPS (sen)	29.0	26.8	34.0	38.5	41.3
Equity	1,818.3	2,007.4	2,404.5	2,678.3	2,987.8	BVPS (RM)	1.46	1.62	1.89	2.10	2.35
						PER (x)	39.6	43.3	33.5	29.9	27.8
						Net div (%)	1.3	1.3	1.5	1.5	1.5
						P/BV (x)	7.9	7.1	6.1	5.5	4.9
Cashflow Statement											
FY Aug (RM m)	2016A	2017A	2018A	2019E	2020E						
Operating CF	130.5	440.0	169.5	640.7	656.9						
Investing CF	(133.5)	(147.0)	(147.4)	(147.1)	(145.5)						
Financing CF	253.7	(180.1)	(184.6)	(358.0)	(368.5)						
Change In Cash	250.7	113.0	(162.4)	135.6	142.9						
Free CF	(19.5)	290.0	19.5	490.7	506.9						

Source: Kenanga Research, Bursa Malaysia

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	6.43	21392.4	Y	03/2019	8.5	9.7	11.0	9.6	48.3	43.5	39.7	10.6	9.5	21.8	1.1	5.15	UP
KOSSAN RUBBER INDUSTRIES	4.38	5601.7	Y	12/2018	1.3	4.2	13.6	4.4	30.5	26.8	25.7	4.9	4.3	16.2	1.4	3.45	UP
SUPERMAX CORP BHD	3.01	1973.5	Y	06/2018	6.4	3.5	10.8	1.9	19.1	17.3	16.9	1.9	1.8	10.6	2.7	2.60	UP
TOP GLOVE CORP BHD	11.50	14698.8	Y	08/2018	4.6	4.6	12.1	7.3	33.5	29.9	27.8	6.1	5.5	18.3	1.5	8.85	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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