

TOP GLOVE'S PAT MARGIN ESTIMATED TO RATIONALISE TO 14%

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Top Glove Corp Bhd

(Jan 7, RM13.84)

Downgrade to neutral with a target price (TP) of RM13.84:

We came away from Top Glove Corp Bhd's analysts' briefing feeling assured of the fundamental prospects of the company. Nevertheless, we believe that current price levels have reflected most of the positive news.

We downgrade our call on Top Glove to "neutral" from "buy" — on valuation grounds — with an unchanged TP of RM13.84.

Top Glove recorded earnings of RM128.4 million in the first quarter of financial year 2016 (1QFY16), the best quarterly results in the company's history.

The stellar start to FY16 was primarily driven by two factors: First, operating efficiency improvements — where concerted effort in the automation, and research and development (R&D) segments has increased production line speeds and glove quality. This led to a higher

profit after tax (PAT) margin (1QFY16: 16%; 4QFY15: 14.5%).

Secondly, it held on to a majority of its foreign-exchange (forex) gains and lower raw material savings. Despite 10% and 5% falls in latex and nitrile raw materials respectively, and a 11% appreciation in the US dollar against the ringgit, the average sales price remained relatively unchanged.

Still, we believe that the PAT margin will rationalise to a more comfortable level of 14%, as it eventually passes on the forex gains and raw material savings to its clients.

It will add a 7.8 billion glove capacity over the next 15 months, bringing total capacity to 52.4 billion, where we forecast the nitrile and latex mixes to improve to 39% and 61% respectively from the current 32% and 68%.

It has reiterated its commitment to the automation and R&D drive to further improve operating efficiency. Also, it is looking to conclude up to two merger and acquisition deals within the glove-related industry in FY16 to help boost growth.

Top Glove Corp Bhd

FYE AUG (RM MIL)	2014	2015	2016F	2017F	2018F
Total turnover	2,275	2,511	3,086	3,365	3,557
Reported net profit	181	280	427	455	486
Recurring net profit	181	280	427	455	486
Recurring net profit growth (%)	(8.1)	55.0	52.7	6.6	6.7
Recurring EPS (RM)	0.29	0.45	0.69	0.73	0.78
DPS (RM)	0.16	0.20	0.34	0.37	0.39
Recurring PER (x)	47.2	30.5	20.0	18.8	17.6
P/BV (x)	6.12	5.31	4.74	4.49	4.31
P/CF (x)	27.1	24.0	14.0	14.4	13.8
Dividend yield (%)	1.2	1.5	2.5	2.7	2.8
EV/Ebitda (x)	32.1	20.5	14.1	13.1	12.2
Return on average equity (%)	13.2	18.6	25.0	24.5	24.9
Net debt to equity (%)	net cash	30.3	15.2	10.1	6.0
Our vs consensus EPS (adjusted) (%)	-	-	5.3	8.4	8.1

Source: Company data, RHB

While we are assured of its fundamental prospects, we believe that its current price level has reflected most of the positive news. Note that Top Glove has risen 207% since end-2014.

We believe the potential upside to the stock would be capped, as Top Glove's price-earnings-to-growth ratio has caught up to the sector's average. Thus, we downgrade our call on Top Glove to "neutral", with an unchanged discounted cash flow-based TP of RM13.84, which implies 20.2 times FY16 price-earnings ratio.

We prefer Supermax Corp Bhd (buy; TP: RM3.84) for its exposure to the rubber glove sector. Upside risks to our recommendation include an extended rerating of the sector driven by liquidity, due to scarcity of earnings growth opportunities. Downside risks include capacity delays, as well as a reversion in the US dollar/ringgit trend and raw material prices.

— *RHB Research*, Jan 7

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