MIDF RESEARCH RETAINS NEUTRAL OUTLOOK FOR TOP GLOVE

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KUALA LUMPUR: MIDF Research is maintaining its Neutral outlook for Top Glove with an unchanged target price (TP) of RM5.31.

It said on Friday its valuation was premised on FY18 EPS of 29.5 sen pegged to an unchanged price-to-earnings ratio (PER) of 18 times which is the company's five-year historical average PER.

"We think this is fair given that we continue to foresee persistent challenges ahead for glove players in general which would lead to slower growth of average selling prices (ASPs) due to the industry's ramp up in capacity as well as potential increase in production costs due to the current higher raw material prices as well as other external factors," it said.

MIDF Research said the re-rating catalyst will be in the form of: (i) significant increase in volume sold; (ii) improvement in ASP and; (iii) launching a new innovative glove product.

"We are maintaining our earnings forecasts for now as we are expecting Top Glove's 2QFY17 to be stronger due to the strengthening of US dollar against the ringgit of late.

“Key risks to our earnings would be: (i) higher than expected increase in production costs i.e: raw material prices, labour costs etc and; (ii) further delays in plant expansions,” it said.

The research house said Top Glove in its 1Q17 analyst briefing on Thursday anticipates a better 2Q earnings performance. This is mainly due to the favourable US dollar against the Ringgit exchange rate this quarter as well as the impact of the increment of its ASP which took place back in October and December last year.

Top Glove management shared that it usually increases its ASP by 3-5% to factor in the changes in various external factors such as currency fluctuations, rising raw materials prices and labour costs.

“We note that the various cost increases are putting pressure on Top Glove’s profit margins. This is especially so with the ongoing increase of both natural rubber as well as nitrile prices which constitute of 48% of Top Glove’s total production costs.

“Aside from favourable US$ and increment in ASP, we opine that Top Glove’s future earnings will also be cushioned by its increasing sales volume. To recall, that during 1Q17, the sales volume during the quarter registered a healthy growth of +7% on-year and +5% on-quarter.

“We think that the company will be able to maintain or register better sales volume growth with the new addition of 1.4 billion capacity in natural rubber gloves that came in last November,” it said.

MIDF Research said Top Glove’s capex to include automation to increase output.

It said the management revealed that it has allocated about RM200mil to RM220mil of capex to fund its capacity expansion as well as to increase automation of its production lines in FY17.

Out of the amount, 75% will be allocated towards capacity expansion while the balance of 25% will be channelled towards production line automation.

This is part of the group’s effort in mitigating the increase in production cost by increasing output via

automation.

“Minimal impact from new foreign worker levy policy. We understand from the management that the new foreign worker levy policy will add an additional 3.5% to the labour costs.

“However, in terms of unit cost, it will only increase by +0.5%, or less than 10 US cents per carton of gloves. Note that Top Glove employs roughly about 7,000 foreign workers currently,” it said.