

# TOP GLOVE TO ADD 74 PRODUCTION LINES, 7.4 BILLION GLOVES YEARLY

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## Top Glove Corp Bhd

(July 9, RM9.13)

Maintain underperform with an unchanged target price (TP) of RM9.40: According to an announcement to Bursa Malaysia, Top Glove Corp Bhd had taken legal proceedings against Adventa Capital Pte Ltd of which the former is claiming for not less than RM714.9 million arising from an alleged conspiracy to defraud wholly-owned Top Care Sdn Bhd and Top Glove. This came as a surprise and raises uncertainty over Aspion Sdn Bhd's future operations and earnings outlook. We maintain our financial year 2018 estimated (FY18E) to FY19E net profit pending further clarifications from management.

Top Care has taken legal proceedings against Adventa as well as Low Chin Guan (the previous owner of Aspion), Wong Chin Toh and ACPL Sdn Bhd. In the writ, Top Glove and Top Care are claiming for an amount of not less than RM714.9 million arising from a conspiracy to defraud Top Care and Top Glove, and fraudulent misrepresentations made by Low

and Wong in relation to the acquisition of Aspion. Top Glove and Top Care are seeking for a Mareva injunction to restrain Adventa from disposing of its assets in Malaysia of up to RM714.9 million pending disposal of the arbitration in the Singapore International Arbitration Centre of which hearing is fixed for July 13, 2018. Recall that Top Glove in April 2018 completed the acquisition (following a term sheet proposal to buy in November 2017) of Aspion, a manufacturer and distributor of surgical, medical and medical examination gloves in Malaysia for RM1.37 billion. The deal comes with a profit guarantee of RM80.9 million and RM108.3 million for FY18 and FY19 (Aspion's financial years end on Oct 31) respectively.

We do not have sufficient details to quantify adverse impact on earnings in relation to uncertainty over the profit guarantee attached to Aspion. Based on our-back-of-the envelope calculation, assuming that we strip out the profit guarantee and assuming normal profits generated from Aspion, our FY19E earnings could be lowered by 12% and our TP lowered to RM8.25 from RM9.40. Assuming that Top Glove is unable to recoup the claims made, an impairment charge of RM714.9 million (assuming the worst-case scenario) will erode Top Glove's book value by 31% from RM1.77 per share to RM1.21 per share as at May 31, 2018. However, we are leaving our FY18E and FY19E earnings and TP of RM9.40 unchanged pending further clarifications from management.

Looking ahead, Top Glove is in the process of constructing two new manufacturing facilities, namely Factory 31 (operational by July 2018) and Factory 32 (operational by early 2019), which upon completion will boost the group's total number of production lines by an additional 74 lines and production capacity by 7.4 billion gloves per annum to 64.9 billion (+11%). Meanwhile, preparations for Top Glove's condom manufacturing facility have also commenced and are expected to be operational by June 2018.

Our TP is unchanged at RM9.40 based on 24.5 times FY19E earnings per share (EPS) (+1.5 standard deviation [SD] above the five-year forward historical mean). The stock is trading at 34.4 times and 31.7 times FY18E and FY19E EPS respectively, which is over +2SD above the five-year historical mean.

A key upside risk to our call is higher-than-expected sales volume.  
— *Kenanga Research, July 9*