NITRILE GLOVE PRICING COMPETITION EASES FOR TOP GLOVE

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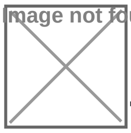

Top Glove Corp Bhd

(June 16, RM4.70)

Maintain buy with a lower target price (TP) of RM6.30: Top Glove Corp Bhd reported revenue of RM672.3 million (-3% quarter-on-quarter [q-o-q]; +2% year-on-year [y-o-y]) for the third quarter ended May 31, 2016 (3QFY16).

The healthy sales volume growth (+5% q-o-q; +11% y-o-y) was commendable, while the overall top line was dragged down by a weaker US dollar and lower average selling prices (ASPs). We estimate that the US dollar ASP has declined by 2% q-o-q and 19% y-o-y, largely due to a supply overhang in the nitrile glove segment.

Its 3QFY16 core net profit fell to RM62.5 million (-40% q-o-q; -14% y-o-y), which was below our earlier estimated range of RM80 million to RM90 million. While we had projected a sequential decline (read: speed bump), we were surprised by the steeper-than-expected margin contraction. Its earnings before interest, taxes, depreciation and amortisation (Ebitda) margin fell sharply to 15% (-8 percentage points q-o-q) on: i) a weaker US dollar versus the ringgit (-6% q-o-q); ii) higher raw material prices (+29% q-o-q); and iii) higher utility costs. Overall, its nine-month period ended May 31, 2016 core net profit missed expectations at 70% of our previous estimate, but was in line with the consensus at 73% of the full-year forecast.

We view the weak 3QFY16 as a blip and expect a sequential recovery in 4QFY16, as the ASP has been adjusted upwards this month. Nitrile glove pricing competition has eased on slower capacity growth, while tailwinds from a weaker ringgit and latex prices should alleviate margin pressure. We also expect incremental sales from the commissioning of two new plants in 4QFY16 to sustain its sequential growth.

We lower our FY16 to FY18E (estimate) earnings by 12% to 13%, largely on lower Ebitda margin assumptions. We still like Top Glove for its attractive valuation at 16 times calendar year 2016 estimate (CY16E) price-earnings ratio (PER) and favourable product mix management in line with its nitrile expansion. We maintain our “buy” call, but with a lower 12-month TP of RM6.30, based on an unchanged CY16E PER of 21 times (+1 standard deviation above its past-three-year mean PER). Risks include currency volatility. — *Affin Hwang Capital*, June 16