

KENANGA IB RESEARCH CUTS TOP GLOVE'S 2016-2017 NET PROFIT ESTIMATES BY 6%

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KUALA LUMPUR (June 16): Kenanga IB Research has downgraded its financial year 2016 and 2017 net profit estimates for glove maker Top Glove Corporation Bhd by 6% following third quarter financial results that is below expectations.

In a note today, the research house maintained its "outperform" call on Top Glove but lowered its target price (TP) to RM6.68 from RM7.

Kenanga Research considered that Top Glove's profit after tax and minority interest (PATAMI) of RM295.4 million (66.9% year-on-year) came in at 71% and 74% of its and consensus full-year net profit forecasts, respectively.

"However, we consider the results as below expectations due to lower-than-expected average selling prices (ASPs) arising from intense price competition.

"Hence, we downgrade our FY16E and FY17E net profits by 6% after taking in account of lower ASPs. Correspondingly, our TP is downgraded from RM7.00 to RM6.68 based on unchanged 20 times FY17E revised earnings per share (EPS)," Kenanga said.

It noted that Top Glove's historical valuation at peak earnings averaged at between 23 and 27 times price-earnings ratio (PER). The PER valuation of Top Glove (14.7 times FY17E PER) has lagged behind Hartalega Holdings Bhd (20.1 times calendar year 2017 PER).

"We consider the under-performance as unwarranted. The valuation gap should narrow when we consider that Top Glove has higher level of total capacity and net profit compared to Hartalega.

"We like Top Glove for its ability to evolve from purely a dominant latex-based rubber gloves producer into a higher margin nitrile-based products producer, undemanding PER valuation at discount to peers, and solid management team," it added.

On Top Glove's outlook, Kenanga said that Top Glove had raised ASPs due to the lag effect in passing cost through as a result of higher natural gas and raw material (latex) costs. The move should contain high operating costs and put brakes on further margin compression in subsequent quarters.

Recall, it added, while pricing adjustments were made accordingly, there was a time lag of two months before the cost increase could be shared out with customers.

"Furthermore, we gather that nitrile glove competition has subsided on the back of slower new incoming capacities, which could ease downwards pressure on ASPs. We expect profit before tax (PBT) margin

to normalise between 13% and 16%," it added.

Kenanga also noted that Top Glove has plans to raise production capacity by additional 7.8 billion pieces of gloves to 52.4 billion (+17%) by end February 2017.

Top Glove reported a 14% drop in third quarter net profit from a year earlier as the rubber glove manufacturer contended with costlier raw materials and fuel.

Top Glove said net profit fell to RM62.46 million in the third quarter ended May 31, 2016 (3QFY16) from RM72.27 million. Revenue was higher at RM672.27 million versus RM661.19 million.

The group's softer performance came on the back of the strengthening of the ringgit against the US dollar during the quarter in review, as well as significant hikes in raw material prices.

Top Glove traded down 10 sen or 2.04% to RM4.81, with 3.3 million shares changing hands.

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