

STRONG BOTTOM LINE EXPECTED FOR TOP GLOVE 2Q

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Top Glove Corp Bhd

(March 14, RM5.25)

Maintain buy with a target price of RM5.80: Top Glove Corp Bhd is scheduled to release its results for the second quarter of financial year 2017 (2QFY17) tomorrow. In tandem with the overall improved sector outlook, we are expecting a sequentially stronger bottom line, mostly underpinned by a higher average selling price (ASP). Despite a hefty increase in raw material prices, we believe Top Glove could pass through the bulk of the increases, although the time-lag factor could distort earnings delivery and an underlying margin recovery in the near term.

We expect firmer sequential revenue growth for 2QFY17, likely to be in the region of +10% quarter-on-quarter (q-o-q). This is likely driven by the revision of the ASP, as well as a weaker ringgit (-6% q-o-q). The higher ASP is a reactive measure against the hefty increase in raw material prices, which has been on an uptrend since late last year with a

combination of speculative as well as seasonal factors. The volume growth should be firmer on the progressive commissioning of Factory 6 in Phuket in November 2016, although we do not expect a significant ramp-up in production output due to the relatively immaterial 1.4 billion capacity addition.

In addition, we expect quarterly profit to be sequentially firmer in tandem with the higher revenue. We look for 2QFY17 earnings to come in within the range of RM80 million to RM85 million, which implies 9% to 16% in earnings growth, but it is likely to be a significant decline year-on-year. That said, our earlier core earnings expectation of RM397 million looks to be overly bullish, thus we are trimming our earnings forecast by 11% for FY17. We are still hopeful of a stronger second half for FY17 given easing pricing pressure, although the persistently high raw material prices could throw a spanner in the works on margin recovery as well as the time-lag factor, which would distort earnings delivery.

We continue to favour Top Glove for its strong volume growth prospects, changing product mix and decent valuations. We expect earnings growth to resume strongly in 2018 on a favourable operating landscape on easing supply growth, which would lead to better pricing management, capacity expansion on aggressive volume growth and margin improvement on lower raw material costs and rising efficiency. Risks include sharp appreciation of the ringgit against the US dollar and a higher-than-expected increase in raw material prices. — *Affin Hwang Capital*, March 14

The Edge Markets