STRONG EARNINGS GROWTH FOR TOP GLOVE, SAYS AFFIN HWANG RESEARCH

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KUALA LUMPUR: Affin-Hwang Capital Research continues to favour Top Glove for its strong volume growth prospects, changing product mix and decent valuations.

It said on Tuesday the world's largest glove maker currently trades at a 16 times CY17E EPS, still below the sector average of 18 times.

"We expect earnings growth to resume strongly in 2018 on: (i) a favourable operating landscape on easing supply growth, which would lead to better pricing management; (ii) capacity expansion on aggressive volume growth; and (iii) margin improvement on lower raw material costs and rising efficiency," it said.

Affin Hwang Research is retaining a Buy call on Top Glove with lower 12 month target price of RM5.80, pegged to an unchanged 18 times CY17E EPS. Risks are a sharp appreciation of the Ringgit against the US$ and higher-than-expected increase in raw material prices.

Top Glove is scheduled to release its 2QFY17 results on Thursday. In tandem with the overall improved sector outlook, the research house is expecting a sequentially stronger bottom line, mostly underpinned by higher average selling price (ASP).

“Despite hefty increases in raw material prices, we believe Top Glove could pass through bulk of the increases, although the time lag factor could distort earnings delivery and an underlying margin recovery in the near term. Maintain Buy”, it said.

The research house expects firmer sequential revenue growth for 2QFY17, likely to be in the region of +10% on-quarter. This is likely driven by the revision in the ASP, as well as the weaker Ringgit (-6% on-quarter).

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.

“Volume growth should be firmer on the progressive commissioning of Factory 6 in Phuket since November 2016, although we do not expect a significant ramp-up in production output due to the relatively immaterial 1.4 billion capacity 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 RM80mil to RM85mil, which implies 9%-16% in earnings growth, but is likely to be a significant decline on-year.

“That said, our earlier core earnings expectation of RM397mil looks to be overly bullish; thus we are trimming our earnings by 11% for FY17. We are still hopeful of a stronger 2HFY17 given easing pricing pressure, although the persistently high raw materials could throw a spanner in the works on margin recovery as well as the time-lag factor, which would distort earnings delivery," it said.