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30 November 2017 | Sector Update

Gloves

***Maintain* NEUTRAL**

22.9% hike in natural gas tariff expected

INVESTMENT HIGHLIGHTS

- **Natural gas tariff increased from RM26.46/MMBtu to RM32.52/MMBtu**
- **Natural gas price revision within producers' expectations**
- **Impact on earnings negligible as hike in cost is transferrable**
- **Maintain NEUTRAL on the sector**

Natural gas tariff increased from RM26.46/MMBtu to RM32.52/MMBtu. On 29 November 2017, **Gas Malaysia Berhad (BUY, TP: RM3.50)** announced that the Government has approved the revision of natural gas tariff for the non-power sector in Peninsular Malaysia from 1 January 2018 to 30 June 2018. The tariff revision is in line with the national rationalisation plan and Gas Cost Pass Through (GCPT) mechanism that includes the revision of piped gas price taking place every six months as indicated by Suruhanjaya Tenaga. The increase in the natural gas tariff is due to the surcharge of RM1.62/MMBtu under the GCPT mechanism which will apply to all tariff categories during the said period due to the increased Liquefied Natural Gas (LNG) price against the reference price in the Base Tariff for this period. Hence, the average effective gas tariff will be revised to RM32.52/MMBtu or +22.9% increase from the current average effective gas tariff of RM26.46/MMBtu. This is higher from the initial planned hike of 16.8% to RM30.90/MMBtu.

Table 1: Revised natural gas tariff schedule

Tariff Category	Annual gas consumption (MMBtu)	Existing Base Tariff (RM/MMBtu)	Revised Base Tariff Effective 1 July- 31 December 2017 (RM/MMBtu)	Revised Base Tariff Effective 1 January – 30 June 2018 (RM/MMBtu)	Revised Effective Tariff after GCPT 1 January – 30 June 2018 (RM/MMBtu)
A	Residential	20.23	18.64	22.30	23.92
B	0-600	26.11	24.52	28.78	30.40
C	601-5,000	26.25	24.66	28.93	30.55
D	5,001-50,000	26.51	24.92	29.22	30.84
E	50,001-200,000	27.66	26.07	30.48	32.10
F	200,001-750,000	27.66	26.07	30.48	32.10
L	Above 750,000	28.58	26.99	31.50	33.12
Average		**28.05**	**26.46**	**30.90**	**32.52**

Source: Gas Malaysia, MIDFR

Natural gas price revision within producers' expectation. Earlier this year, Gas Malaysia announced the schedule of gas price revisions that will take place for the next three years until 2019. In the announcement, it indicated that it is expecting a +16.8% increase in natural gas base tariff to RM30.90/MMBtu (from RM26.46/MMBtu) for the period of 1 January 2018 to 30 June 2018. However, due to the increase in LNG price against the base tariff for this period, the average effective gas tariff is now increased by +22.9% to RM32.52/MMBtu.

We understand from our checks with management of glove producers, the hike in natural gas tariff is within the glove producers' expectations as the quantum of increase is not far off from what was communicated earlier by Gas Malaysia and the hike in tariff has been provided for.

Impact on earnings negligible as hike in cost is transferrable. Most of the major glove players fall within the category F and L where according to our calculation will experience +22.9% increments in effective gas tariff from the newly announced tariff. On average, natural gas constitutes of about 10-12% of the total glove production costs for the glove producers under our coverage. Hence, our preliminary calculation shows that all four glove producers under our coverage will have a reduction in earnings of about 10% arising from this latest revision in natural gas tariff as the hike will cause the natural gas cost to increase by about 3.0%. However, we believe that the impact on the glove producers will be negligible as the glove producers will pass on the entire cost increase to their customers which will in turn result in higher average selling prices (ASPs).

Maintain NEUTRAL on the sector. The increase in average effective natural gas tariff in general is negative news for the overall sector, and as mentioned earlier, the impact on earnings will be about 10% reduction in net profit for the glove producers. This is assuming that the glove producers do not pass on the cost increase to their customers which we believe is the unlikely scenario. Furthermore, we have taken into consideration the potential hike in natural gas tariff in our earnings forecasts as Gas Malaysia has previously provided the guideline on the potential hike each year which minimizes the impact of the increase in the natural gas tariff.

Hence, we maintain our **NEUTRAL** stance on the sector as we remain wary of the: (i) movements in raw materials price; (ii) movements in currency and; (iii) lag in industry expansion progress. Our Top Picks for the sector is Hartalega. We like Hartalega for its: (i) earnings visibility; (ii) superior profit margins compared to its peers; (iii) efficient cost management and; (iv) uninterrupted capacity expansion.

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TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
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TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
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POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.