

17 July 2017 | Sector Update

Gloves Sector

Maintain NEUTRAL

Assessing the impact of natural gas tariff reduction

INVESTMENT HIGHLIGHTS

- Natural gas tariff reduced from RM28.05/MMBtu to RM26.46/MMBtu
- Natural gas price revision a positive surprise
- Negligible impact on earnings
- Maintain NEUTRAL on the sector

Natural gas tariff reduced from RM28.05/MMBtu to RM26.46/MMBtu. On 14 July 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 July 2017 to 31 December 2017. 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 reduction in the natural gas tariff is due to the rebate of RM1.59/MMBtu under the GCPT mechanism which will apply to all tariff categories during the said period. Hence, the average effective gas tariff will be revised from RM28.05/MMBtu to RM26.46/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 2017 (RM/MMBtu)	Revised Effective Tariff after GCPT (RM/MMBtu)
A	Residential	19.26	20.23	18.64
B	0-600	24.86	26.11	24.52
C	601-5,000	24.99	26.25	24.66
D	5,001-50,000	25.2	26.51	24.92
E	50,001-200,000	26.33	27.66	26.07
F	200,001-750,000	26.33	27.66	26.07
L	Above 750,000	27.21	28.58	26.99
Average		26.71	28.05	26.46

Source: Gas Malaysia, MIDFR

Natural gas price revision a positive surprise. 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 +5.0% increase in natural gas base tariff to RM28.05/MMBtu (from RM26.71/MMBtu) for the period of 1 July 2017 to 31 December 2017. However, due to the rebate from the GCPT mechanism, the increase in the average effective gas tariff is now reduced to +0.57% as the average effective gas tariff for the said period is now reduced to RM26.46/MMBtu. The +0.57% increase is in comparison to the previous average effective gas tariff RM26.31/MMBtu for the period of 1 January 2017 to 30 June 2017. We deem the reduction in the hike of natural gas tariff a positive surprise for the glove producers as the quantum of increase is <1.0% (from the initial +5.0%) which will assist in lowering gloves production costs and offset some of the impact of volatility coming from raw materials price and currency movements.

Negligible impact on earnings. Most of the major glove players fall within the category F and L where according to our calculation will experience on average <1.0% increment in effective gas tariff from the previous 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 negligible impact on earnings of about <1.0% arising from this latest revision in natural gas tariff. In addition, we believe that the impact on the glove producers will be minimal as the glove producers will have to pass on the cost savings to their customers which will in turn result in lower average selling prices (ASPs).

Maintain NEUTRAL on the sector. While the reduction in average effective natural gas tariff in general is a positive news for the overall sector, however, as mentioned earlier, the impact on earnings will be fairly minimal at <1.0% impact on net profit. Furthermore, this is assuming that the glove producers do not pass on the cost savings to their customers which we believe is the unlikely scenario.

Hence, we maintain our **NEUTRAL** stance on the sector as the sector lacks re-rating catalyst at this juncture. Furthermore, we remain wary of the: (i) movements in raw materials price; (ii) movements in currency and; (iii) slowdown in industry expansion progress. Our Top Picks for the sector are Hartalega and Kossan. 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. Meanwhile, we like Kossan for its: (i) earnings visibility; (ii) prudent management and; (iii) revamped old production lines plus 3.0b new nitrile capacity coming in July 2017. 

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

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.