

27 December 2018 | Sector Update

Gloves Sector

Maintain NEUTRAL

Minimal impact on gas tariff hike

INVESTMENT HIGHLIGHTS

- Natural gas tariff increased minimally by 23.0sen or 0.7% to RM32.92/MMBtu
- Natural gas normally constitutes approximately 10% to 12% of total glove production costs
- Negligible impact of less than one percent on FY19 earnings of glove companies under our coverage
- Maintain NEUTRAL on the sector

Minimal increase in natural gas tariff by 23.0sen to RM32.92/MMBtu. On 26 December 2018, **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 2019 to 30 June 2019. 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. Hence, the average effective gas tariff will be revised from RM32.69/MMBtu to RM32.92/MMBtu. We are neutral on this revision as the increase in effective gas tariff is only +0.7% from the previous revised tariff.

Table 1: Revised natural gas tariff schedule


Tariff Category	Annual gas consumption (MMBtu)	Current Base Tariff (RM/MMBtu)	Current Tariff after GCPT (RM/MMBtu)	Base Tariff Effective 1 January–30 June 2019 (RM/MMBtu)	Revised Tariff after GCPT Effective 1 January–30 June 2019 (RM/MMBtu)
A	Residential	23.03	23.80	23.49	23.72
B	0-600	29.73	30.50	30.35	30.58
C	601-5,000	29.88	30.65	30.51	30.74
D	5,001-50,000	30.19	30.96	30.81	31.04
E	50,001-200,000	31.49	32.26	32.15	32.38
F	200,001-750,000	31.49	32.26	32.15	32.38
L	Above 750,000	32.55	33.32	33.23	33.46
Average		31.92	32.69	32.69	32.92

Source: Gas Malaysia, MIDFR

Negligible impact on earnings. Most of the major glove players fall within the category F and L. According to our calculation, on average, they will experience <1.0% increment in effective gas tariff from the previous tariff. Moreover, on average, natural gas constitutes only about 10-12% of the total production costs for the glove producers under our coverage. Hence, according to our calculations, all four glove producers under our coverage will experience negligible impact on earnings of about <1.0% arising from this latest revision in natural gas tariff as the increase in effective gas tariff is only +0.7% compared to the previous period. In addition, we believe that the impact on earnings will be fairly minimal due to the: (i) current low raw material costs, i.e. Nitrile Butadiene Rubber (NBR) and natural rubber; (ii) opening of new plants with latest technology which is energy efficient; and (iii) cost past-through mechanism whereby the cost increase will be shared with customers.

Impact. We are making no changes to our recommendations, earnings estimates and target prices of the glove producers under our coverage at this juncture.

Maintain NEUTRAL on the sector. We view that demand for glove will continue to increase, driven by more stringent hygiene requirement. Glove manufacturers will capitalise on this demand by continuously expanding its production capacity. However, there are risks that overexpansion in capacity would lead to downward pressure in ASP and higher operating costs. In order to maintain operating costs, we take comfort in knowing that glove manufacturers are actively looking at ways to reduce the escalating cost of labour and energy. Bearing this in mind, we expect that the glove player's profit margin will remain stable.

On another note, glove producers under our coverage are currently trading at a premium of +20.0% above their historical two-year PER. As such, we recommend investors that have been accumulating on the stock to sell on strength. All things considered, we are maintaining our **NEUTRAL** stance on the sector. 

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> 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.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% 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.