

15 July 2019 | Sector Update

Gloves Sector

Maintain NEUTRAL

Upward revision on gas tariff

INVESTMENT HIGHLIGHTS

- Natural gas tariff rose by RM1.74 to RM34.66/MMBtu
- The revision will impact glove manufacturers' 3QCY19 earnings
- Glove prices are expected to be revised from September 2019
- Maintain NEUTRAL on the sector, accumulate Kossan and Supermax


Natural gas tariff rose by RM1.74 to RM34.66/MMBtu. On 12 July 2019, **Gas Malaysia Berhad (BUY, TP: RM3.11)** announced that the Government has approved the revision of natural gas tariff for the non-power sector in Peninsular Malaysia from 15 July 2019 to 31 December 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 the Energy Commission. Hence, the average effective gas tariff will be revised upwards by RM1.74 to RM34.66/MMBtu.

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 15 July–31 December 2019 (RM/MMBtu)	Revised Tariff after GCPT Effective 15 July–31 December 2019 (RM/MMBtu)
A	Residential	23.49	23.72	23.52	25.44
B	0-600	30.35	30.58	30.40	32.32
C	601-5,000	30.51	30.74	30.56	32.48
D	5,001-50,000	30.81	31.04	30.86	32.78
E	50,001-200,000	32.15	32.38	32.20	34.12
F	200,001-750,000	32.15	32.38	32.20	34.12
L	Above 750,000	33.23	33.46	33.28	35.20
Average		32.69	32.92	32.74	34.66

Source: Gas Malaysia, MIDFR

Downward impact on 3QCY19 earnings. This revision represents an increase in effective gas tariff of +5.3% from the previous revised tariff i.e. RM32.92/MMBtu. In terms of annual gas consumption, the major glove players fall within the category F and L (above 200,000 MMBtu). In addition, natural gas constitutes of about 13% of the total glove production costs for all four glove manufacturers under our coverage. Hence, according to our calculations this revision will have impact on earnings of about <5.0% especially for the 3QCY19 performance. Nonetheless, we expect that glove prices will be revised from September 2019 in line with the cost past-through mechanism in the industry whereby the cost increase will be shared with customers.

Maintain NEUTRAL on the sector. We are making no changes to our recommendations, earnings estimate and target price of the gloves producers under our coverage at this juncture. To maintain operating costs at bay, we take comfort in knowing that glove manufacturers are actively looking at ways to reduce the escalating cost of energy and labour. At this juncture, we have of a positive view on the medium size glove manufacturers as they play catch up in terms of capacity and improving plant efficiency with the bigger manufacturers. Despite thinning profit margin due to the pricing pressure, **Kossan Rubber Industries Berhad (BUY, TP: RM4.53)** and **Supermax Corporation Berhad (BUY, TP: RM2.07)**'s new plants will be equipped with both energy efficient and high automated production lines. Coupled with a significant increase in production volume, we expect their profit margins will improve going forward. Moreover, both stocks trade at a more attractive valuation in comparison to the bigger peers. As such, we recommend investors to accumulate the stock on weakness. All things considered, we are maintaining our **NEUTRAL** stance on the sector. 

Nabil Zainoodin, CFA, CA
nabil.zainoodin@midf.com.my
03-2772 1663

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

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.